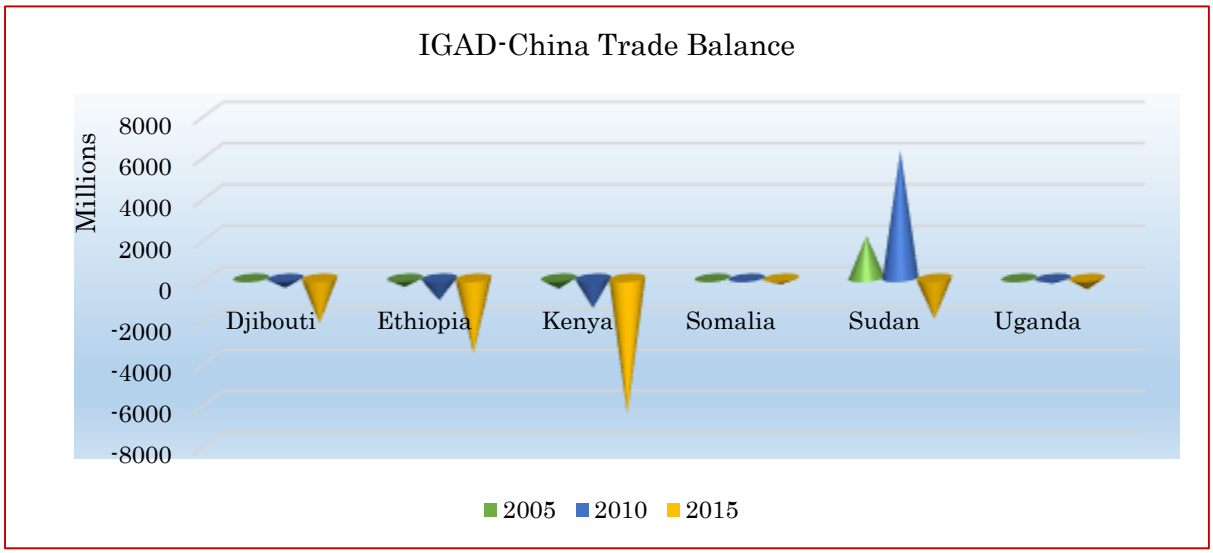
The Horn Economic and Social Policy Institute

MACROECONOMIC PERFORMANCE OF IGAD AND THE IMPLICATIONS OF CHINA'S ECONOMIC SLOWDOWN



April, 2017

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INTRODUCTION

The Inter-Governmental Authority on Development (IGAD) as one of the relatively newly constituted regional block is composed of diverse countries with varied economic structures and agro-ecological zones. Member states (that includes Djibouti, Eritrea, Ethiopia, Kenya, Somalia, Sudan and Uganda) also vary in terms of population sizes ranging from the second most populous country in Sub-Saharan Africa (Ethiopia) to a country with a population of less than a million (Djibouti). The state of security in each of the countries is also mixed ranging from relatively stable states to others engulfed with political turmoil. The levels of development as measured by income also vary ranging from Least Developed to Middle Income countries.

As a whole, the IGAD region lags behind other Regional Economic Communities (RECs) in the continent or elsewhere measured in terms of income level attained to date, the level of trade flows (global and regional) registered, the economic diversity of the countries, the level of financial depth and the economic efficiency with which the economies of the region operate. This issue will be discussed in relation to the performance of the global economy in general and the economic slowdown in China in particular in Part II of this report, suffice it to say here that the current state of these economies are both weak and vulnerable to external and instability and various natural or man-made shocks. In addition to that it includes countries in which the current political stability is less conducive for a stable macroeconomic environment (in South Sudan and Somalia, for instance). Despite these apparent weaknesses, the region's potential is quite huge because of the following attributes. Among these resources is the yet to be fully exploited size of livestock[1] that exists in the IGAD region. The livestock sector contributes nearly 60 percent to the combined agricultural GDP of the IGAD sub-region, ranging from 20 percent in Uganda to close to 90 percent in Somalia; the sector is also the main source of livelihood for close to 40 million population across the region (FAO, n.d).

The IGAD region also has a young and growing population with a potential for market expansion and entrepreneurial skills. About half of the population is below the age of thirty. As shown in Appendix 3, the size of the population of the eight member countries is projected at half a billion (out of the two billion in Sub Saharan Africa) by 2050. This is the case since the growth rate is also comparable to the rest of Sub-Sahara African countries (SSA). This indicates that the region is one of the highly populated regions and has a huge customer base and young population with a potentially active labor force. These attributes are likely to expand the domestic market and attract investors to expand production and sale of goods and services both for the domestic market and exports. Such an attribute coupled with the huge natural resource believed to exist in the region points to a promising prospect for the region once political stability is obtained and the existing administrative problems are addressed and the economic bottlenecks are removed. That is, the region has a long way to go to address the current obstacles it faced and when these are addressed, the region has a bright future.

It has to be noted that population pressure is viewed as positive contributor to a sustained economic growth. But this is only true when the transition is managed properly or economic and population growth rates move in tandem or are synchronized. That is, if and when population growth significantly

[1] This is a sector that needs further research, a comprehensive and careful study for the IGAD member countries to fully, efficiently utilize this huge resource in the region. HESPI plans to explore the role and importance of this sector in detail in its future research.

exceeds the economy's ability to absorb the existing labor force, it chokes economic growth rather than helping its progress. In fact this may even hamper stability of the political economy of any country facing such a miss-match, as seems to create some pressure in some IGAD member countries. In particular, a population structure that is skewed towards the young age group (as is the case with most IGAD countries with a population of about 60% still below the age 30) creates both a huge dependency ratio and excess unemployment even under normal circumstances. This embodies both political and economic problems, at least in the transition, before economies find a way of finding jobs for such an uneven distribution of the population.

In what follows, after assessing the performance of the macro-economy in Part I. Part II will examine recent developments in the global economy, in particular, the likely impact of the economic slowdown and rebalancing in China on the economies of IGAD countries that have established substantial close economic relationships, particularly in trade, investment and infrastructure development.

PART ONE: Macro-economic Review of IGAD Economies

1.1. Developments in the Real Sectors of IGAD Economies

1.1.1. Economic Growth

The macroeconomic performance of IGAD economies in the last fifteen years has been mixed. While most countries performed better than the African average growth rates, some have performed worse than the continental average. Ethiopia, Sudan and Uganda performed better than the African average of 5.1 percent between 2000 and 2015. The performance of Kenya and Djibouti was worse than that of the African average; while that of Eritrea, Somalia and South Sudan was not compared on account of incomplete data (see Table 1).

A comparative five year average performance of member countries also shows roughly similar picture in which Ethiopia, Sudan and Uganda performed better than all SSA average while the remaining countries lagged behind. In the last five years 2011-2015, Djibouti, Ethiopia, Kenya and Uganda performed better than the African average of 4 percent while that of Sudan declined from the previous years. The data for the remaining countries of Eritrea, Somalia and South Sudan was not complete to render comparison. As the details could be seen from Table 2, the GDP growth of the relatively larger member countries (except Kenya up to 2010) has been consistently higher than that of the African average. Another attribute of the economies of IGAD countries is inconsistency in the growth of most countries. Not only what are called fragile states of IGAD countries but even the countries with a relatively good performance on the whole (Djibouti, Kenya and Sudan in recent years) have exhibited some inconsistency in their growth performance.

Based on the available data, the worst two performers in the region are South Sudan and Eritrea. That of South Sudan seems to be due to the internal conflict once oil exports had stopped flowing, before which the economy was doing very well. But the Eritrean case is difficult to explain, since the country had been relatively stable after the end of the war with Ethiopia in 1998-2000.

Table 1: Annual GDP growth of IGAD countries (%) in 2000-2015

Year	Djibouti	Eritrea	Ethiopia	Kenya	Sudan	S. Sudan	Uganda	SSA
2000	0.4	-3.1	6.1	0.6	6.3	--	3.1	3.6
2001	2	8.8	8.3	3.8	6.5	--	5.2	3.9
2002	2.6	3	1.5	0.5	6.4	--	8.7	3
2003	3.2	-2.7	-2.2	2.9	7.7	--	6.5	4.9
2004	3.8	1.5	13.6	5.1	3.9	--	6.8	11.6
2005	3.2	2.6	11.8	5.9	7.5	--	6.3	5.5
Average	**2.5**	**1.7**	**6.5**	**3.1**	**6.4**	**--**	**6.1**	**5.4**
2006	4.8	-1	10.8	6.5	10.1	--	10.8	7.1
2007	5.1	1.4	11.5	6.9	11.5	--	8.4	7.1
2008	5.8	-9.8	10.8	0.2	7.8	--	8.7	5.3
2009	5	3.9	8.8	3.3	3.2	5	7.3	2.8
2010	3.5	2.2	12.6	8.4	3.5	5.5	5.2	5.5
Average	**4.8**	**-0.7**	**10.9**	**5.1**	**7.2**	**5.3**	**8.1**	**5.6**
2011	4.5	8.7	11.2	6.1	-2	-4.6	9.7	4.3
2012	4.8	--	8.6	4.6	-2.2	-46.1	4.4	3.6
2013	5	--	10.6	5.7	3.3	13.1	3.3	4.7
2014	6	--	10.3	5.3	3.1	3.4	4.8	4.6
2015	--	--	9.6	5.6	3.4	-6.3	5	3
Average	**5.1**	**8.7**	**10.1**	**5.5**	**1.1**	**-8.1**	**5.4**	**4**
Overall Average	**3.9**	**1.2**	**9**	**4.4**	**5.2**	**-3.1**	**6.6**	**5.1**

Source: World Bank (2016)

Among the IGAD member states, Ethiopia is a top growth performer in 2015 with a GDP growth of 9.6 percent followed by Kenya with 5.6 percent and Uganda with 5 percent. Sudan, on the other hand, had output contraction in 2011-12 following South Sudan's secession, and it seems it has yet to recover well. The country registered an economic growth of around 3 percent for the past three years.

At a sectoral level, the industrial value added grew by close to 22 percent in Ethiopia, 8 percent in Uganda, 7 percent in Kenya and 6 percent in Sudan. The observed high growth rate in the industrial value added in Ethiopia is mainly attributed to the construction sector.

Table 2: Annual Growth in Industry Value Added (%)

	2005	2010	2011	2012	2013	2014	2015
Djibouti	5.4	--	--	--	--	--	--
Eritrea	-9.0	--	--	--	--	--	--
Ethiopia	9.4	10.8	15.0	19.6	24.1	17.0	21.7
Kenya	4.4	8.7	7.2	4.2	5.3	6.5	6.9
Sudan	2.8	7.8	-8.3	-10.3	-1.0	6.7	6.1
Uganda	11.6	7.8	11.4	3.1	4.3	3.9	7.9

Source: World Bank (2016)

On average, the performance of the agriculture sector was positive in 2015 but the attendant drought in 2016 is likely to negatively affect its performance. The sub-region especially in Kenya, Somalia, Uganda and South Eastern Ethiopia was hit by drought exacerbated by the El Nino. The resulting drought has directly impacted the region leading to food insecurity, child malnutrition and famine. FAO (2016) estimates that close to 24 million people have faced critical and emergency food shortage in the first two quarters of 2016. Consequently countries in the region could experience low agriculture value added in the 2016 harvest year.

Table 3: Annual Growth in Agriculture Value Added (%)

	2005	2010	2011	2012	2013	2014	2015
Djibouti	3	--	--	--	--	--	--
Eritrea	69.6	--	--	--	--	--	--
Ethiopia	13.5	5.1	9	4.9	7.1	5.4	6.4
Kenya	6.9	10.1	2.4	2.9	5.4	3.5	5.6
Sudan	2.2	0.7	7	2.5	5.9	2.6	3.1
Uganda	2	3.2	2.9	1.1	1.8	3	3

Source: World Bank (2016)

And as was the case for the overall GDP and the other sectoral growth rates, the value added in the service sector in Ethiopia was also the highest. It is also to be noted that the service sector in Ethiopia has also surpassed the agriculture sector in terms of its share in GDP in recent years. As was the case for industry and agriculture value added, the valued for the service sector in Djibouti, Somalia, South Sudan and Eritrea is not available. In Kenya and Uganda, annual growth in service value added has been modest with 5.5 and 5.3 percent in 2015 respectively. But the service value added growth in Sudan has declined steadily from 15.4 percent in 2005 to 2.7 percent in 2015.

Table 4: Annual Growth in Service Sector Value Added (%)

	2005	2010	2011	2012	2013	2014	2015
Djibouti	2.5	--	--	--	--	--	--
Eritrea	-4.3	--	--	--	--	--	--
Ethiopia	12.3	16.7	13.0	9.9	9.1	12.9	10.1
Kenya	4.6	7.3	6.1	4.7	5.4	5.8	5.5
Sudan	15.4	5.1	4.8	3.2	2.4	3.0	2.7
Uganda	6.2	5.9	12.4	4.9	4.0	4.3	5.3

Source: World Bank (2016)

1.1.2. Investment and Saving

Gross national saving is gross disposable income less final consumption expenditure after taking account of an adjustment for pension funds. For many countries, the estimates of national saving are built up from national accounts data on gross domestic investment and from balance of payments-based data on net foreign investment. In many developing countries in general and IGAD member countries in particular, saving significantly lags behind investment. This usually results in deteriorating domestic resource balance, particularly when foreign flows are very weak. The main culprit of domestic resource gap is inadequate saving rate relative to attendant rate of investment.

Table 5: Gross National Savings (% of GDP)

	Djibouti	Eritrea	Ethiopia	Kenya	South Sudan	Sudan	Uganda
2005	22.9	-28.4	17.1	17		13.1	27.4
2006	25.4	-17.8	13	16.7		15.6	24.4
2007	23.8	-10.3	21.9	17.3		17.6	26.5
2008	23.5	-9	20.8	14.2		19.5	20.1
2009	30.4	-9.7	15.4	14.9		11.4	21.2
2010	21.9	-9.3	24.5	14.8		18	18
2011	11.4	1.2	33.1	12.5	23.5	18.6	19.5
2012	7.8	5.9	31.2	13.1	-5.2	9.4	22.7
2013	17.2	3.6	28.1	11.2	11.3	11.5	20.8
2014	18.5	4	26.7	11	13.6	10.5	16.8
2015	31.2	1.3	27	14.4	7.1	9.5	17.7
Average	21.3	-6.2	23.5	14.3	10.1	14.1	21.4

Source: IMF, Regional Economic Outlook (2016)

As shown in table 6, over the last ten years, gross national savings as a share of GDP slightly improved in Djibouti, Ethiopia and Uganda while the rate was very low in Eritrea and South Sudan. In Kenya and Sudan it averaged around 15 percent, during the same period. Between 2005 and 2015, investment as a share of GDP registered a significant growth exceeding the saving rate by a huge margin in all the member countries for which data has been obtained[2]. In particular, without inferring causality, the countries with a relatively higher saving rate such as Djibouti, Ethiopia and Uganda registered bigger investment to GDP shares between 2005 and 2015.

Table 6: Gross National Investment (% GDP)

	Djibouti	Eritrea	Ethiopia	Kenya	South Sudan	Sudan	Uganda
2005	26.1	20.3	22.4	18.2		23.1	29.7
2006	36.9	13.7	23.9	18.6		24.5	28
2007	45.2	12.7	20.8	20.5		23.6	30.9
2008	47.8	12.7	21.2	19.6		21.1	27.7
2009	40.1	9.3	24.7	19.3		21	27.6
2010	21.2	9.3	25.5	20.7		20.1	26
2011	25.2	10	32.1	21.7	5.5	19.1	29.5
2012	28.1	9.5	37.1	21.5	10.7	18.7	29.5
2013	40.5	8.7	34.1	20.1	12.5	20	27.8
2014	44.1	7.9	34.5	21.4	11.5	17.3	26.4
2015	60.4	7.6	39.8	22.5	9.9	17.3	26.
Average	37.2	11.4	28.2	20.3	9.7	20.9	28.3

Source: IMF, Regional Economic Outlook (2016)

[2] Investment or gross capital formation is measured by the total value of the gross fixed capital formation and changes in inventories and acquisitions less disposals of valuables for a unit or sector.

1.2. The Monetary Sector

1.2.1. Money Supply

The growth of money in most IGAD countries has not exhibited a stable growth rate. In particular, the growth rate of money in most of the countries showed a spike in some years while declined to a negative territory in others. For instance, in Djibouti money grew by about 21 percent in 2008 only to decline by about -4.6 percent in 2011. Similarly, in Ethiopia, money grew by -13 percent in 2007 only to grow by 23 percent in 2008, 37 percent in 2011, 33 percent in 2012 and by about 25 percent in the next three years that followed. This instability in the growth of the money supply has also characterized the South Sudanese economy which grew by 62 and 188 percent in the last two years.

Table 7: Annual Money Supply Growth (%)

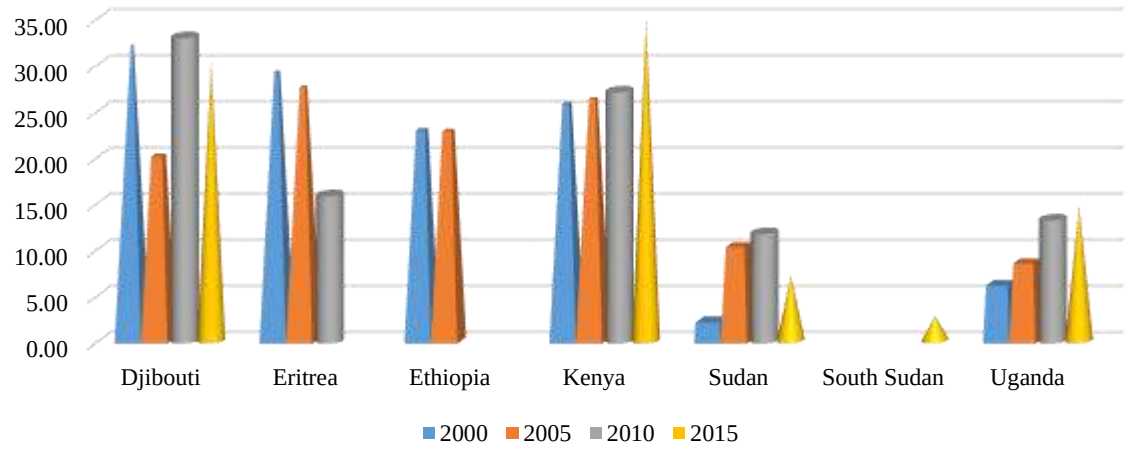
	Djibouti	Eritrea	Ethiopia	Kenya	South Sudan	Uganda
2005	11.3	10.7	13.1	9.2		17.2
2006	10.2	5.7	12.3	17.0		16.9
2007	9.6	12.1	-13.3	19.1		22.0
2008	20.6	15.9	22.9	15.9		30.8
2009	17.5	15.7	19.9	16.0		16.6
2010	12.2	15.6	24.4	21.6		41.5
2011	-4.5	14.6	36.5	19.1		10.5
2012	15.1	17.9	32.9	14.1	33.9	14.9
2013	6.9	17.5	24.2	15.6	-1.6	9.5
2014	6.5	17.2	26.9	16.7	21.2	15.2
2015	19.0	13.9	24.2	13.7	62.4	11.7
2016*	4.2	16.0	18.7	17.4	188.0	18.4

Source: IMF, Regional Economic Outlook (2016)
NB. * indicates IMF projection

On the other hand, the growth of money in Kenya seems to be relatively stable. This was also the case in Uganda except in 2008 when it grew by 31 percent and in 2010 by about 42 percent.

The bulk of credit in all the economies is given to the public and not to the private sector. As indicated in Fig. 1, domestic credit to the private sector in all the countries did not exceed 35% of the total between 2000 and 2015. This is another indicator that the weak state of the private sector and the dominance of the public sector in economic activity and its share of the available credit.

Fig. 1: Domestic credit to private sector (% of GDP)

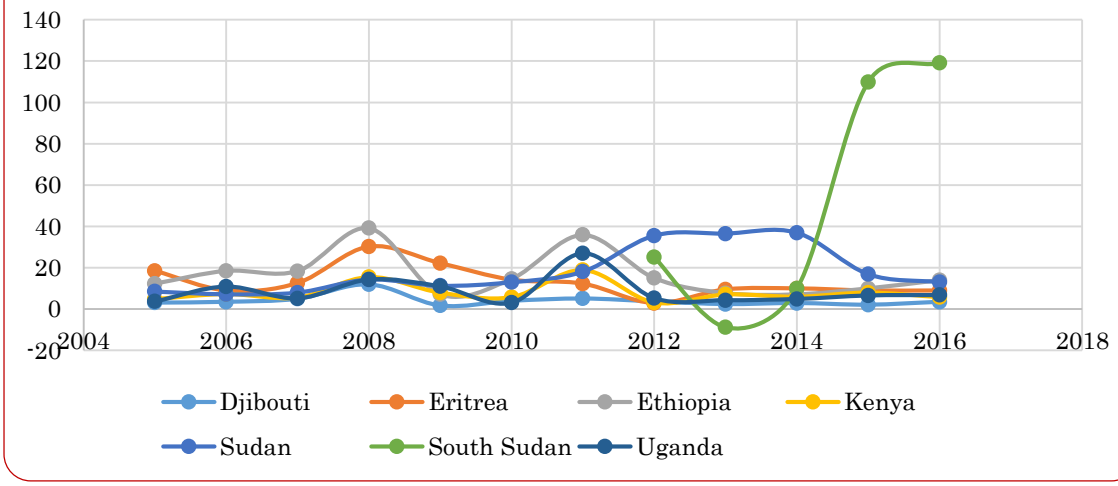


Source: World Bank (2016)

1.2.2. Price Movements

The consumer price changes, as noted in Fig. 1, mimic the movements in money supply. For instance, inflation in Djibouti, Uganda and Kenya (Eritrea as well except in 2008 & 2009) remained relatively stable, for the most part in single digits. On the other hand, in countries like Ethiopia, Sudan and South Sudan, inflation jumped by a significant margin in some years. The increase in broad money supply and the rise in inflation coincided with the border conflict in Eritrea and Ethiopia and the conflict in both Sudan and South Sudan between 2012 and 2014. That is, without inferring causality, therefore, the relatively relaxed quantitative easing in the countries and the attendant price movements occurred in tandem in the specific years noted.

Fig. 2: Consumer Prices, End of Period, Percent change, Previous period, Percent



Source: IMF, Regional Economic Outlook (2016)

1.2.3. Interest Rates

The real interest rate, by definition, also reflects the movements in the price level and the growth of the money supply. The data in some of the countries is incomplete. for those countries with data, the real interest in Djibouti, Ken, Uganda and South Sudan seem to be too high viewed in terms of their likely impact on investment even though will likely encourage saving. Particularly in Ethiopia, the negative interest in the previous decade reflects the high inflation rate observed during that period and the overall financial depression probably due to high government intervention in the financial market. On the whole, the link between money supply, inflation and real interest rate seems to be a congruence between theoretical expectations and actual observation.

Table 8: Real Interest Rate (%) for IGAD Countries (2000-15)

	Djibouti	Ethiopia	Kenya	South Sudan	Uganda
2000	9.31	1.30	15.33		10.62
2001	9.32	17.64	17.81		17.33
2002	10.59	12.74	17.36		23.00
2003	9.42	-5.11	9.77		10.33
2004	7.98	2.97	5.05		4.34
2005	7.99	-2.62	7.61		21.77
2006	7.82	-4.08	-8.01		15.91
2007	5.73	-8.29	4.82		10.98
2008	0.01	-17.12	-0.98		13.24
2009	11.47		2.84		-9.74
2010	6.24		12.03		8.68
2011	6.08		3.84		14.77
2012	7.48		9.45	7.74	3.78
2013	9.34		11.34	0.95	18.48
2014	9.45		7.89	16.30	17.49
2015	9.31		6.36	12.02	16.67

Source: World Bank (2016)

1.3. Fiscal Developments in IGAD Countries

Fiscal Developments in the IGAD region as narrowly defined to compromise government revenue and expenditures, including the net balance exhibited a negative resource balance across member countries. This emanated from the weak economic performance in the region in collecting taxes which resulted in revenue lagging behind expenditure that are deemed essential for socio-economic development needs in each country.

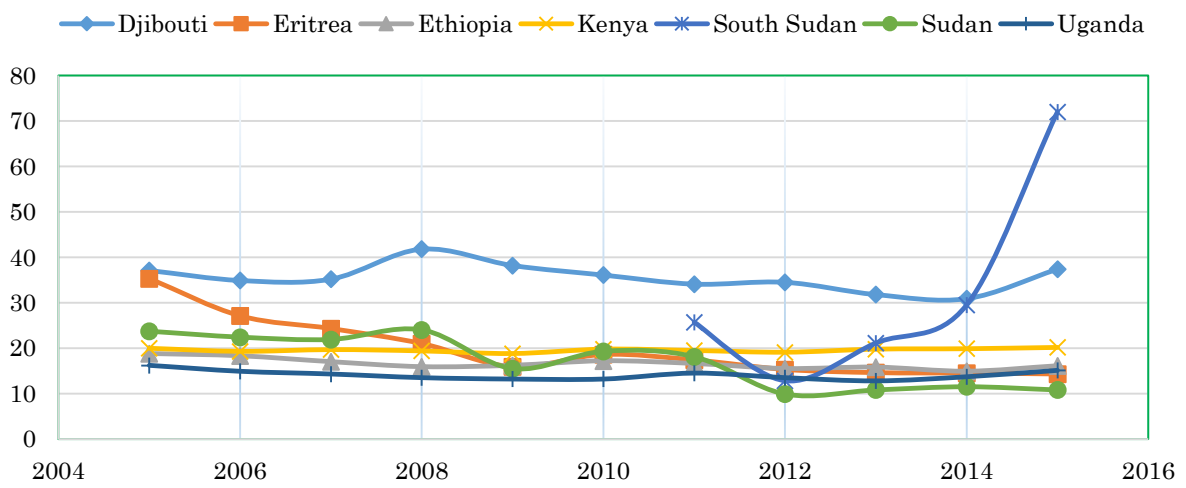
1.3.1. Government Revenue

Government Revenue consists of taxes, non-tax revenue. Revenue increases government's net worth, which is the difference between its assets and liabilities particularly from sources such as government enterprises. It is to be noted that transactions that merely change the composition of the balance sheet do not change the net worth position; for example, proceeds from sales of physical assets for cash (in the absence of variations in valuation) does not change the net worth of assets only its composition.

The size of resource mobilization as measured by general government revenue as a share of each country's GDP varies across IGAD member countries. On average, Djibouti and South Sudan registered

the highest levels of domestic resource mobilization as a percent of GDP, followed by Kenya and Eritrea at about 20 percent of GDP. Ethiopia, Sudan and Uganda, on average, registered domestic resource mobilization of 15 percent between 2005 and 2015. Clearly, the two countries with highest revenue to GDP ratio (Djibouti and South Sudan) are economies endowed with an active port service and oil revenue, respectively. These factors partly suggests the reliance of their economies on these resources while the other sectors of the economies contribute less to the respective economies.

Fig. 3: General Government Revenue (% GDP)

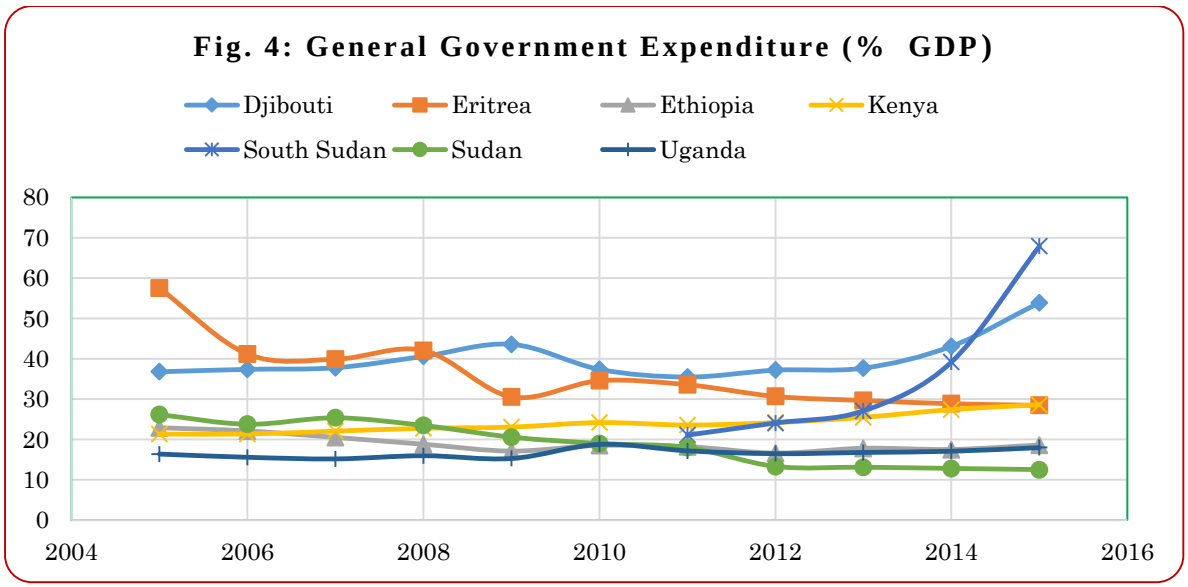


Source: World Economic Outlook, 2016

1.3.2. Government Expenditure

As was the case in revenue mobilization, the relatively smaller economies of Djibouti, Eritrea and South Sudan had a significant share of government expenditure as a share of GDP, averaging more than 35 percent between 2005 and 2015. This heavy involvement of government as measured by its revenue and expenditure share in GDP indicates that the share of the private sector relative to GDP is relatively small. Countries with relatively diversified and larger economies like that of Sudan, Kenya, Ethiopia, and Uganda registered less expenditure shares to GDP, on average accounting to less than 20 percent.

The public sector seems to be playing a more pivotal role in the relatively smaller economies partly because (a) their revenue is specific resource based (port services in Djibouti, minerals and remittances in Eritrea, and oil in South Sudan); and (b) the revenue sources are all publicly owned, and (c) the private sector's role is weak in terms of its share in the economy. These factors seem to indicate the relatively heavy involvement of the public sector in the economy.



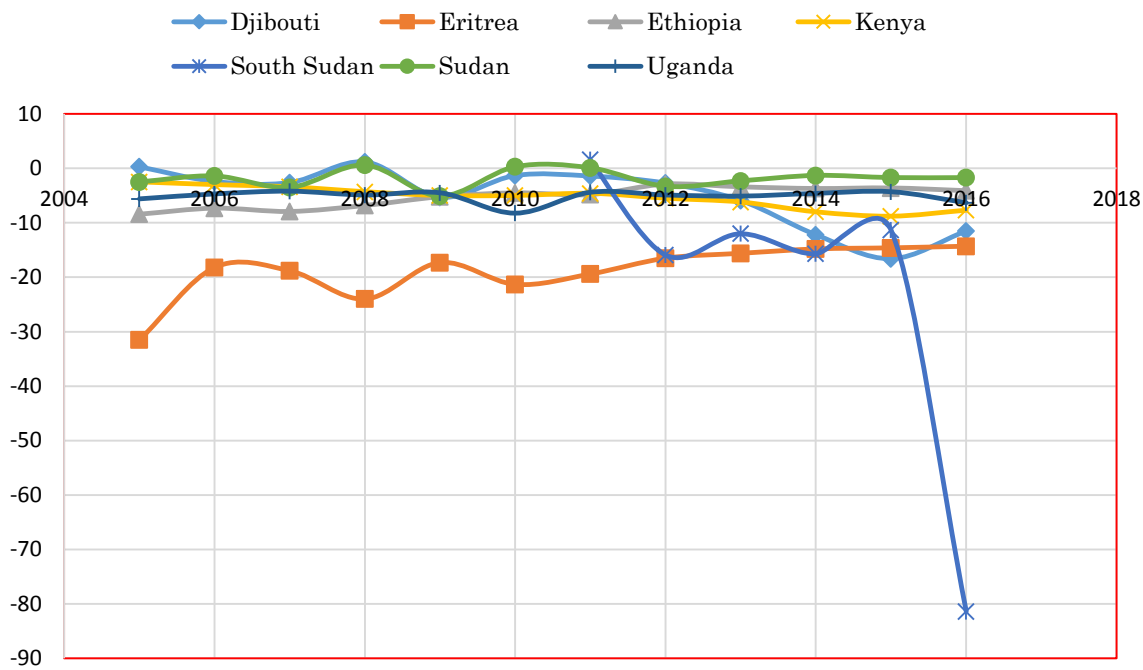
Source: World Economic Outlook, 2016

1.3.3. Overall Government Balance

All IGAD member countries have registered a negative resource balance between 2005 and 2015. That is, public expenditure exceeded the total revenue mobilized in most of all the last fifteen years. The level of deficit, however, varied across time and across countries. During the period in question, the average deficit balance varied between 23 percent of GDP in South Sudan to about 2 percent in Sudan. The deficit seems to be more pronounced in countries where the economy is heavily reliant on specific resources (Eritrea and South Sudan) than an overall economic performance.

The factors that seemed to have influenced the main negative resource gap in many IGAD member countries are (a) the inefficiency in collecting taxes since in almost all the countries the tax buoyancy is very weak (i.e. crudely measured as the growth in tax collected falling short of the growth in GDP), (b) the huge informal sector as a share of GDP believed to exist, and (c) the overall weak economic performance of the respective economies.

Fig. 5: Overall Fiscal Balance, General Government (% Of GDP)



Source: IMF, Regional Economic Outlook (2016)

1.4. International Financial Flows

International financial flows to a country consist of various sources ranging from foreign direct investment (FDI), remittances from abroad, and other flows that come in the form of aid or grants. Here we focus on flows related to FDI and remittances.

1.4.1. Foreign Direct Investment

Foreign direct investment is the net inflow of investment or asset acquisition or interest in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. The series (in table 8) shows net inflows (new investment inflows less disinvestment) in the reporting economy from foreign investors, and is divided by GDP. In the absence adequate domestic saving, FDI flows augment savings in a country. As noted above, all IGAD member countries face domestic resource constraint and, hence, FDI flows are of paramount value in both alleviating the savings constraint and in expanding employment opportunities. It also has the potential to alleviate foreign exchange constraints and to facilitate technology transfer.

Table 9: Foreign Direct Investment, net inflows (% of GDP)

	Djibouti	Eritrea	Ethiopia	Kenya	Sudan	Somalia	S Sudan	Uganda	SSA
2005	3.1	0.1	2.1	0.1	5.9	--	--	4.2	2.8
2006	14.1	1.3	3.6	0.2	5.1	--	--	6.5	2.0
2007	23.0	0.5	1.1	2.3	3.3	--	--	6.4	3.2
2008	22.8	2.8	0.4	0.3	3.0	--	--	5.1	3.7
2009	9.2	4.9	0.7	0.3	3.2	--	--	4.7	3.6
2010	3.2	4.3	1.0	0.4	3.1	--	--	2.7	2.1
2011	6.4	1.5	2.0	0.3	2.6	--	--	4.4	2.7
2012	8.1	--	0.6	0.3	3.7	--	--	5.2	2.2
2013	19.7	--	2.0	0.7	2.5	8.3	-6.0	4.4	2.2
2014	9.6	--	3.8	1.5	1.7	7.6	0.0	3.9	2.5
2015	--	--	3.5	2.3.	2.1	8.7	-3.1	4.0	2.1
Average	11.9	3.4	1.9	0.6	3.3	8.2	-1.9	4.7	2.6

Source: World Bank (2016)

In the IGAD region, despite the small size of the economy (or may be because of it) FDI has had an appreciable ratio to GDP in Djibouti (about 12 percent), while in all the other countries it was very small as proportion of GDP (except in South Sudan that is oil related). In absolute amounts (as shown in Appendix 4), Ethiopia and Sudan were the largest FDI recipients in 2015 with US $ 2.2 Billion and US $1.7 Billion respectively; Kenya and Uganda had also received huge FDI in the same year.

1.4.2. Remittance Inflows

Personal remittances comprise personal transfers and compensation of employees. Personal transfers consist of all current transfers in cash or in kind made or received by resident households to or from nonresident households. Personal transfers thus include all current transfers by nonresident individuals including compensation of employees, seasonal workers, and other short-term workers who are employed in an economy where they are not resident and of residents employed by nonresident entities. Data are the sum of two items defined in the sixth edition of the IMF's Balance of Payments Manual: personal transfers and compensation of employees.

The official data on remittance inflow to the region is usually low compared to the actual inflow given the fact that in developing countries the cost of sending money through formal institutions is very high. Hence migrants use alternative ways to send money back home using informal channels. Even though cost of sending money globally have declined reaching around 7.4 percent of the total amount, the cost of remitting money to Sub-Saharan Africa remains stubbornly high, exceeding 9.5 percent (World Bank, 2015).

In Horn of Africa, internal conflict (including instability in South Sudan and Somalia) together with persistent drought in the region has led to increased forced migration in the region. Accordingly because of huge number of diaspora based community, these countries depend heavily on remittances for a large share of private consumption and investments.

Table 10: Personal Remittances received (% of GDP)

	Djibouti	Ethiopia	Kenya	Sudan	Uganda	SS Africa
2005	3.6	1.4	2.3	2.7	3.6	3.2
2006	3.7	1.1	2.2	2.2	4.1	3.3
2007	3.4	1.8	2	2.2	3.7	3.2
2008	3	1.4	1.9	2.9	5.1	2.9
2009	3.1	0.8	1.7	2.6	4.4	2.9
2010	2.9	1.2	1.7	2.2	3.8	2.3
2011	2.6	1.6	2.2	1.2	4	2.4
2012	2.5	1.4	2.4	1	3.9	2.3
2013	2.4	1.3	2.4	0.9	3.8	2.2
2014	2.3	1.2	2.3	0.7	3.3	2.1
2015				0.2	4	
Average	3	1.3	2.1	1.9	4	2.7

Source: World Bank (2016)

As indicated in table 10, the amount of remittance flowing to IGAD member countries as a share of their GDP is very small. The share relative to GDP in some of the countries (Djibouti and Uganda, for instance) exceed the Sub Saharan average. In terms of volume remittance inflows, however, there had been an improvement in Kenya, Sudan and Ethiopia, though the ratio seems small due to the size of the economies.

1.5. External Sector Development in IGAD Economies

1.5.1. The Export Sector

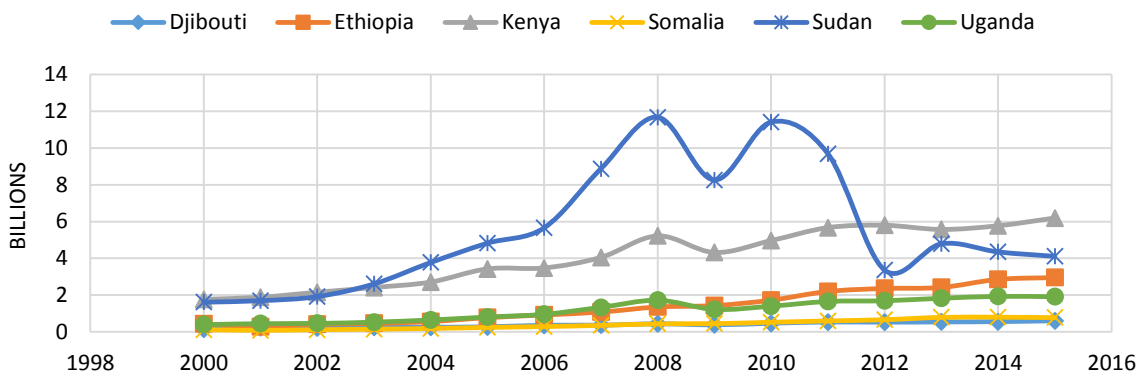
The export sector in IGAD member counties measured in terms of annual proceeds of US Dollar receipts reveals a mixed picture in the last 18 years (1998-2015) or so. While exports in Sudan fluctuated significantly that of Kenya show a steady increase particularly in recent years. Exports of the other countries however have shown little or no significant rise during the period.

As discussed in part II of the report, exports to China (or China's imports from IGAD member countries) noticeably declined in the last three years (2013 – 2015). This is in tandem with the observed cooling down of the Chinese economy in the last few years. For instance, as will be discussed in Part II, according to IMF estimates, the growth of Chinese economy has slowed down since 2011 and is still expected to decline further in the coming years. Hence, this probably has markedly affected some of the countries that have a strong trade ties with china (such as Ethiopia in which China is the largest trading partner).

The main challenge of the export sector of IGAD member countries is that most of the region's exports are based on primary commodities with little or no value added. This leads to low value of the exports and also primary commodities are directly affected when productions in the importing countries slows down. Exports of finished products might not have been immediately affected or not to a large extent, since slowdown in consumer expenditure lags behind production activities. Hence in both magnitude of export value and vulnerability to external shocks, exports of IGAD member countries are exposed to

an immediate and direct impact to volatility in foreign economies. Similarly IGAD countries imports (mainly manufactured commodities) have grown substantially especially from China over the last decade. Due to price consideration and ease of visa restrictions, trade with China has grown fast in a very short period of time. Hence, China has served not only as a primary export destination (at least for some countries) but also as a source of imports for IGAD member states.

Fig. 6: IGAD Member States Merchandise Exports (In USD Billions)

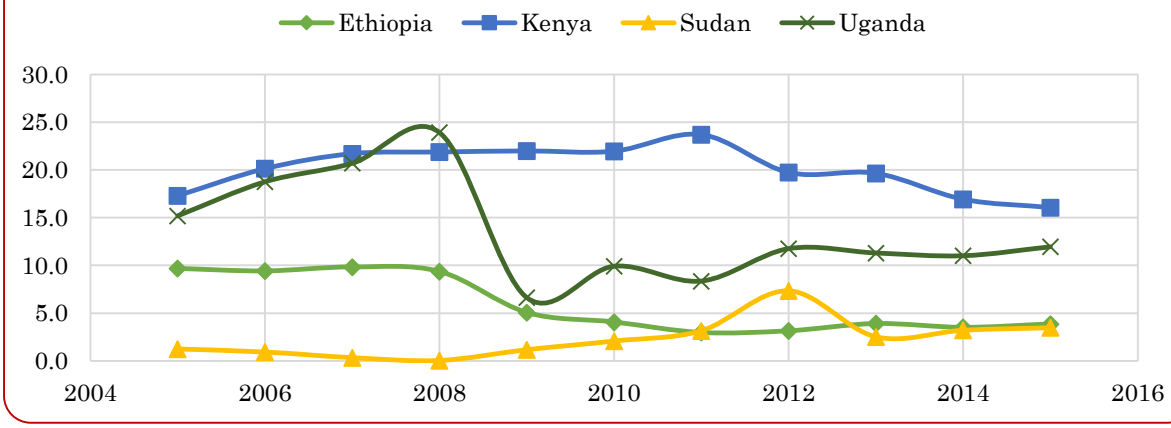


Source: IMF, Direction of Trade Statistics

1.5.2. Intra-IGAD Trade

IGAD's progress in promoting regional integration relative to other Economic communities in the continent has been poor, despite the fact that market integration and broad regional economic integration remain a key objective (Byiers, 2016). Intra-regional trade remains small. In Figure (7) below the level of intra-regional exports of IGAD members shows that Kenya and Uganda (which are both members of the East African Community) exports much to other member states relative to each countries global export. On the other hand Sudan and Ethiopia's exports to other IGAD member states is significantly very low.

Fig. 7: Intra-regional Trade In IGAD



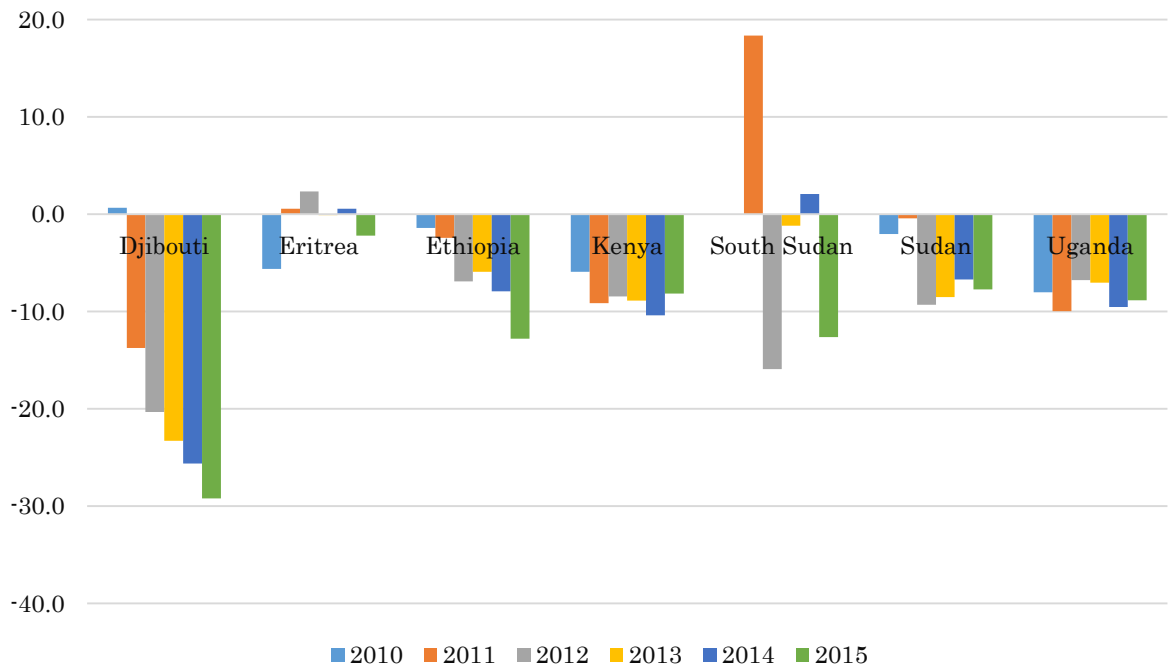
Source: HESPI Computation based on IMF, Direction of Trade Statistics

1.5.3. External Balance

Current account is all transactions other than those capital flows, and the major classifications are goods and services, income and current transfers. The focus of the Balance of Payments (BOP) is on transactions (between an economy and the rest of the world) in goods, services, and income. If we focus on the physical flow of goods and services the two categories that constitute the current account balance is the flow of imports and exports of goods and services. The net balance between these two categories is the trade balance, and as other current transactions are included, a national current account balance is computed as a measure of balance of payments current performance indicator.

Almost all IGAD member countries with available data registered a negative current account balance between 2010 and 2015, except South Sudan in 2013. This shows that IGAD countries face what is known as twin deficits; these include the saving and investment gap and the external gap or current account deficit. Furthermore, in almost all countries the negative current account balance worsened in the last few years indicating that growths in exports lagged behind imports (see figure 8).

Fig. 8: CAB (% of GDP) for IGAD economies



Source: IMF, Regional Economic Outlook (2016)

PART TWO: The Implications of China's Economic Slowdown & Rebalancing for the IGAD Economies

2.1. Introduction

China has experienced a sustained economic growth over the past three decades through 2010, registering an annual average growth rate of 10 percent which not only enabled many Chinese to get

out of extreme poverty but also stimulated growth in many parts of the world (IMF, 2016). But since 2011, the country's economic growth has slowed down to below 7 percent in 2015 and will continue to decelerate in the coming few years (IMF, 2016).

Over the years, China has been an important development partner for most African countries including the IGAD region in their endeavor to industrialize their economies and lift their population out of abject poverty. In 2000, the Forum on China-Africa Cooperation (FOCAC) was created to further strengthen China-Africa relation; and the first Ministerial Conference under the FOCAC framework was held in Beijing in 2000. Following the Beijing and subsequent FOCAC meetings, the Chinese government introduced important measures to facilitate relations with the African continent. These measures, which cover a wide range of sectors and areas, include debt relief, zero-tariff treatment, investment promotion, provision of further development assistance and concessional loans, science and technology cooperation and human resource development. As of January 2015, twenty-four Least Developed Countries from Africa including all IGAD economies except Eritrea and Kenya has benefitted from duty-free treatment to 97 per cent of China's import tariff lines. Eritrea has not yet completed the formalities with the Chinese Government to benefit from this treatment but continue to benefit from the second phase of preference coverage which represents 95 per cent of China's import tariff lines (UNCTAD, 2016).

As the result of the different initiatives and growing interest in the continent, Chinese trade with IGAD relation grew significantly from US $ 1.2 billion in 2000 to about US $ 18 billion. In the early 2000s, the trade balance was in favor of IGAD; but since 2011, IGAD's exports to China (mainly because oil exports after South Sudanese secession declined owning to instability) plummeted significantly and IGAD has run a whopping trade deficit against China.

Besides the growing trade relations, China has been a key source of foreign direct investment (FDI) and finance. Over the past decades, Chinese businesses have been flocking to the African continent and are making sizable investment in different sectors. Chinese FDI stock to IGAD countries grew from US $ 34.1 million in 2003 to more than US $ 4.1 billion by 2014.

Similarly Chinese loans to IGAD governments mainly to mega infrastructure projects, with particular focus on hydropower generation, roads and railways in the sub-region grew steadily in 2003-2014[3]. Standard Gauge Railway in Kenya; Addis Ababa City Light Railway in Ethiopia; the Lamu Port South Sudan Ethiopia Transport (LAPSSET) Corridor—which will link Kenya with Ethiopia, Uganda and South Sudan; the Addis Ababa-Djibouti railway; Addis-Adama high-way construction, Entebbe-Kampala Toll Road in Uganda; and Khartoum Airport expansion in Sudan are some of the project financed by China.

Recently, China has experienced slowdown in economic growth and is undergoing transformation, which could impact the rest of the world. Its economy is rebalancing from investment and export driven to domestic consumption based economy which is more likely to generate spillovers to many countries especially those economies which rely on commodity exports through trade, investment and financial flows (Dizioli et al, 2016[4]; Chen and Nord, 2016[5]). Following the slowdown in GDP growth, China's

[3] China-Africa Research Initiative, John Hopkins University

[4] Spillovers from China's Growth Slowdown and Rebalancing to the ASEAN-5 Economies

[5] A Fork in the Road: China's new growth strategy could hurt Africa's commodity-dependent economies

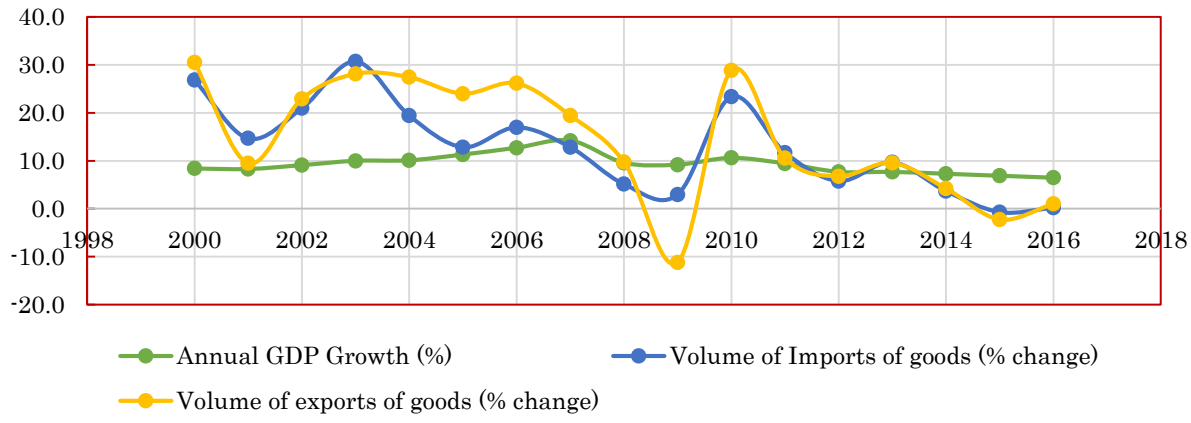
global imports as well exports measured in volumes stalled in 2015 compared to 2014. Hence it is imperative and fitting to examine and assess IGAD member states' exposure to China through the different channels i.e. trade, investment and finance. Accordingly, this section of the paper is organized in three parts, which examine the trade, investment and financial exposure of IGAD economies to China.

2.2. Chinese Economic Growth and Rebalancing

In 1978, under the leadership of Deng Xiaoping, the Chinese Communist Party promulgated comprehensive economic reform and opened up its economy to the world. The economic policy shifted from a centrally planned economy to a market based economy. Since then, China has recorded one of the fastest and sustained economic growth in the modern era. In 1978-2011, the Chinese economy grew at an average of 10 percent. Poverty measured by the percentage of people living on the equivalent of US$1.90 or less per day declined from 88 percent in 1981 to 6.5 percent in 2012. In 2009, China overtook Japan as the second largest economy in the world next to USA with close to US $5.1 trillion (measured at current US$). Given its population size and remarkable economic growth, China has been an important player in the global economy.

Since 2011, the Chinese economic growth momentum has slowed down and is expected to continue in the coming few years; other economic indicators such as producer price index, merchandise exports and imports volumes have also weakened. Annual GDP growth has continued to decelerate from 10.6 percent in 2010 to 6.9 percent in 2015. Similarly, the annual percentage change in the volume of merchandise imports as well as exports has stalled (see fig. 8). In 2015, the volume of merchandise exports and imports of China declined by 2.2 and 0.7 percent, respectively. On top of the economic slowdown, the Chinese economy is transforming from investment and exports driven to consumption based. The economic slowdown coupled with the rebalancing will have a profound impacts on the global economy especially on those developing countries which heavily depended on commodity exports (Lakatos et al, 2016; Dizioli et al, 2016; Chen and Nord, 2016). Lakatos et al (2016) found that a 1 percent Chinese economic slowdown over 2016–30 is expected to result a 1.1 percent decline in Sub-Saharan Africa GDP and 0.6 percent globally relative to the past trends scenario by 2030.

Fig. 9: China: GDP Growth & Exports & Imports of Goods volume (% change)



Source: IMF World Economic Outlook Database (2016)

2.3. IGAD-China Trade Relations

The traditional trading partners for most African countries including for the IGAD sub-region are mostly the Advanced Industrial countries of US, Europe, and Japan. But recently China in particular and other emerging economies such as Brazil, India and some Middle Eastern countries (such as UAE and Saudi Arabia) have become important trading partners for the IGAD region and for the Sub-Saharan African countries in general. In the early 2000s, China-IGAD bilateral trade was very low. IGAD economies (excluding Eritrea) exported US $ 697 million and imported US $ 486.5 million from China in 2000. But since then, the overall trade between China and IGAD grew significantly until it was hit hard during the 2008/09 global financial crisis. In 2009, the bilateral trade between China and IGAD declined by 18 percent relative to 2008. As can be seen in fig. (10), IGAD sub-region as a whole had trade surplus against China until 2011. But in 2012, the region's exports to China decelerated considerably while the regions imports from China remained on course. Consequently, IGAD experienced massive trade deficit against China for the first time since 2000 and continued to grow since then.

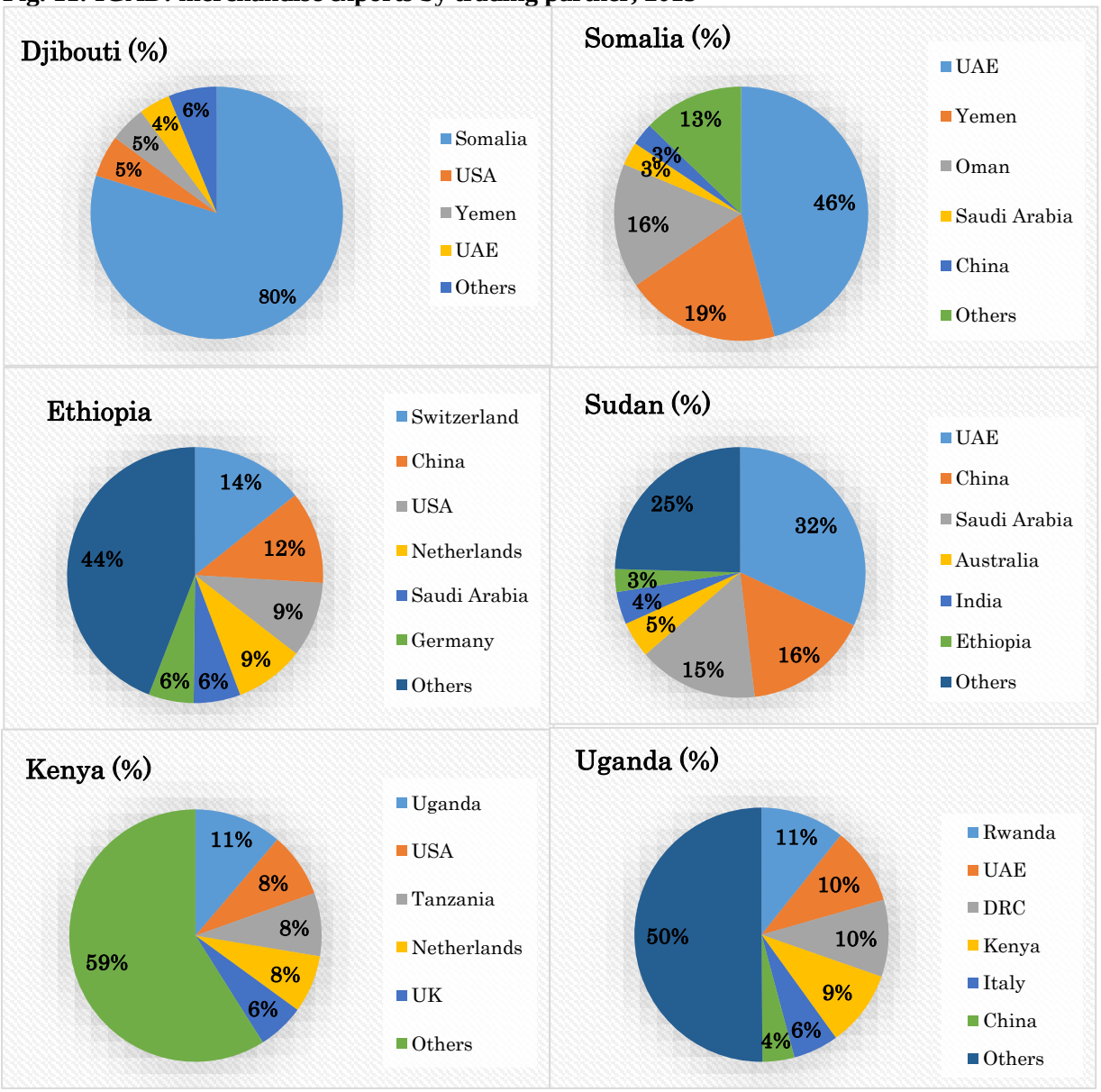
Fig. 10: China-IGAD Trade

Source: HESPI Computation based on IMF Direction of Trade Statistics

* The total trade for IGAD does not include Eritrea and South Sudan; whereas China trade includes Hong Kong, Mainland China and Macao

Trade relation between IGAD member states and China varies significantly from country to country. For Sudan, Ethiopia, and Uganda, China is a strategic and important trading partner. Ethiopia which recorded one of the fastest economic growth in the continent over the last decade exports mainly to EU, US and Japan. Ethiopia's trade relation with other members of IGAD is insignificant; it is only Djibouti which is among the top ten exports market for Ethiopia. With regard to Ethio-China trade relation, China is the second most important export destination and the largest source of imports for Ethiopia. In 2015, Ethiopia's exports to and imports from China was around US $ 346 million and US $ 3.8 billion respectively.

Fig. 11: IGAD: merchandise exports by trading partner, 2015



Source: HESPI Computation based on IMF, DOTS (2016)

Kenya, the economic powerhouse of East African Community (EAC), trades more with other members of the EAC. In 2015, Kenyan exports to Uganda, Tanzania and Rwanda constituted more than 22 percent of its global exports. In addition, US, the Netherlands and the UK are among the top five exports market destinations for Kenya. Kenya's exports to China amounted to less than US $ 150 million which only constituting 2.4 percent of its global exports. On the other hand, its imports from China valued more than US $6.7 billion in 2015. Just like Kenya, Uganda exports much to other members of the East African Community particularly to Kenya and Rwanda, and also to the neighboring Democratic Republic of Congo (DRC). Uganda's exports to China has steadily increased over the years. In 2005, Uganda's export to China was only 2.4 percent but by 2015 its share increased by more than double making China among the top ten exports destination for Uganda's exports (see figure 11).

Sudan, an oil exporting economy in the IGAD region, depended heavily on China for its oil exports.

In 2005, more than 70 percent of its exports (which constituted mostly petroleum) was to China. But in 2015, Sudan's exports to China fell drastically to 16 percent due to a multitude of factors such as the decline in oil price, the reduction in oil production following the secession of South Sudan and also the slowdown in Chinese demand for raw materials. United Arab Emirates and the Kingdom of Saudi Arabia are the other two important trading partners for Sudan.

Table 11: IGAD member states' export to China (% of global exports) - 2005-2015

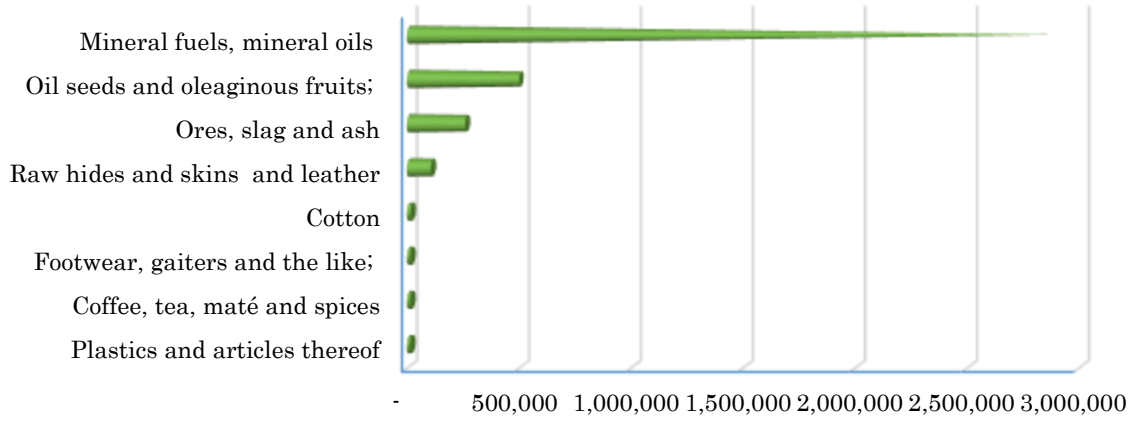
	Djibouti	Ethiopia	Kenya	Somalia	Sudan	Uganda
2005	0.4	10.9	1.5	1.5	71.1	2.4
2006	0.4	11.1	1.0	1.1	75.0	2.0
2007	1.0	6.3	0.9	0.5	82.1	1.8
2008	1.2	6.5	1.0	0.1	75.0	1.7
2009	0.0	13.8	1.3	0.1	75.8	2.4
2010	0.2	14.7	1.2	0.4	72.5	2.7
2011	0.8	12.6	1.4	1.0	65.2	2.9
2012	0.3	12.7	1.6	0.9	1.6	3.4
2013	0.6	12.8	1.6	2.3	35.9	5.0
2014	0.4	16.5	1.8	3.5	30.2	6.6
2015	0.3	12.5	2.4	2.9	16.2	5.7

Source: HESPI computation based on IMF DOTS (2016)

2.3.1. Commodity Composition of China-IGAD Trade

Like the rest of African countries, IGAD member states heavily depend on agricultural raw materials for foreign exchange earnings. Hence their exports to China concentrates on few agricultural commodities such as oil seeds, raw hides and skins, coffee & tea. In addition to these traditional commodities, IGAD countries have seen rising exports of footwear products in recent times especially Kenya and Ethiopia. Sudan and South Sudan, on the other hand, rely heavily on oil exports. The lion share of these two exports to China has been dominated by petroleum exports. In 2015, both Sudan & and South Sudan earned more than 3 billion from oil exports of which close to 99 percent was to China (UNCOMTRADE, 2016).

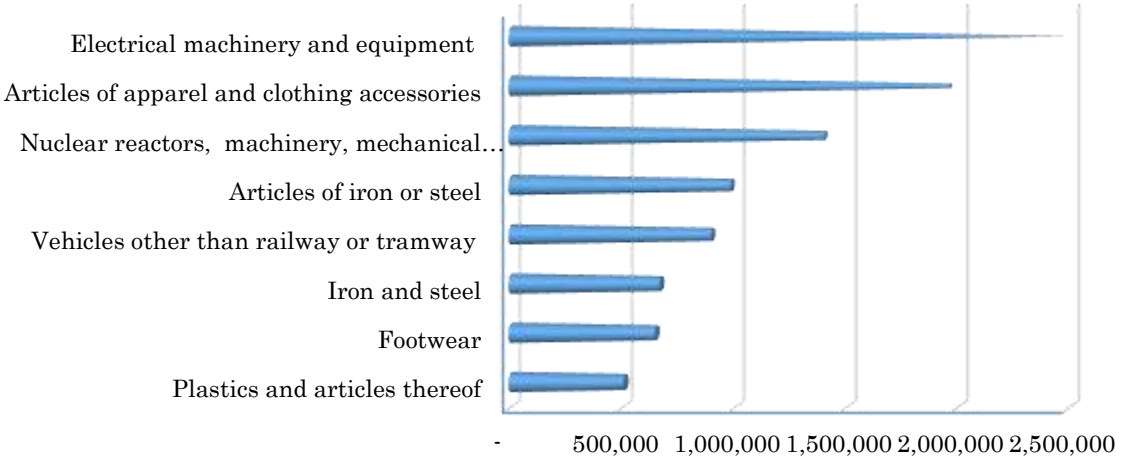
Fig. 12: China: Imports from IGAD by commodities in 2015 ('000)



Source: HESPI's computation based on International Trade Centre Data

China's exports to IGAD economies has grown significantly from US $ 420 million in 2000 to close to US $14.6 billion in 2014. Of these growing China's exports to IGAD economies, electrical & electronic equipment, apparel, machinery and nuclear reactors constitute the largest share (see fig. 12).

Fig 13: China: Exports to IGAD Countries by commodities in 2015 ('000)



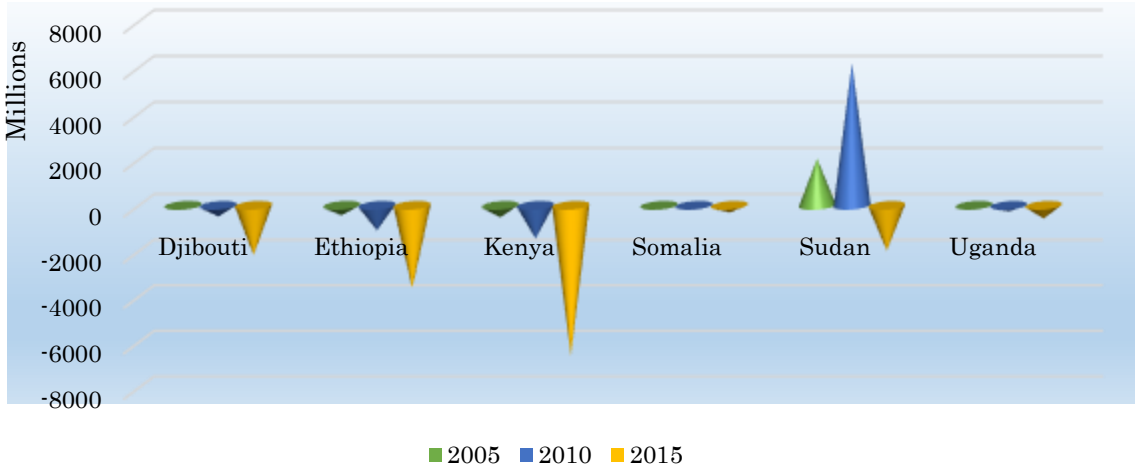
Source: HESPI Computation based on IMF, DOTS (2016)

2.3.2. Trade Balance of IGAD with China

Chinese rising demand for raw materials over the past three decades benefitted developing countries, which depend on those commodities. As commodity exporting economies, the IGAD region has experienced rising trade ties with China and other emerging economies. IGAD countries' imports from China have grown considerably in 2005-2015. For example, Djibouti's imports from China were below US $130 million in 2005 which grew well over US $ 2 billion in 2015; that of Ethiopia was US $520 million in 2005 and US $4 billion in 2015. Likewise IGAD countries' exports to China has also improved over those years. In the early 2000, IGAD economies as a whole run a trade surplus against China; but since 2011, the overall trade balance of IGAD against China has been deteriorating.

There is significant variation in the trade balance of IGAD economies at national level. Djibouti, Ethiopia and Kenya's trade have seen rising trade deficits since 2005; whereas that of Somalia and Uganda have maintained relatively modest trade deficit with China. The oil exporting economy in the region, Sudan, had a trade surplus until 2011. In 2010, Sudan's trade surplus with China was more than US $ 6 billion but by 2015, the country has a trade deficit of close to US $ 2 billion.

Fig. 14: IGAD-China Trade Balance



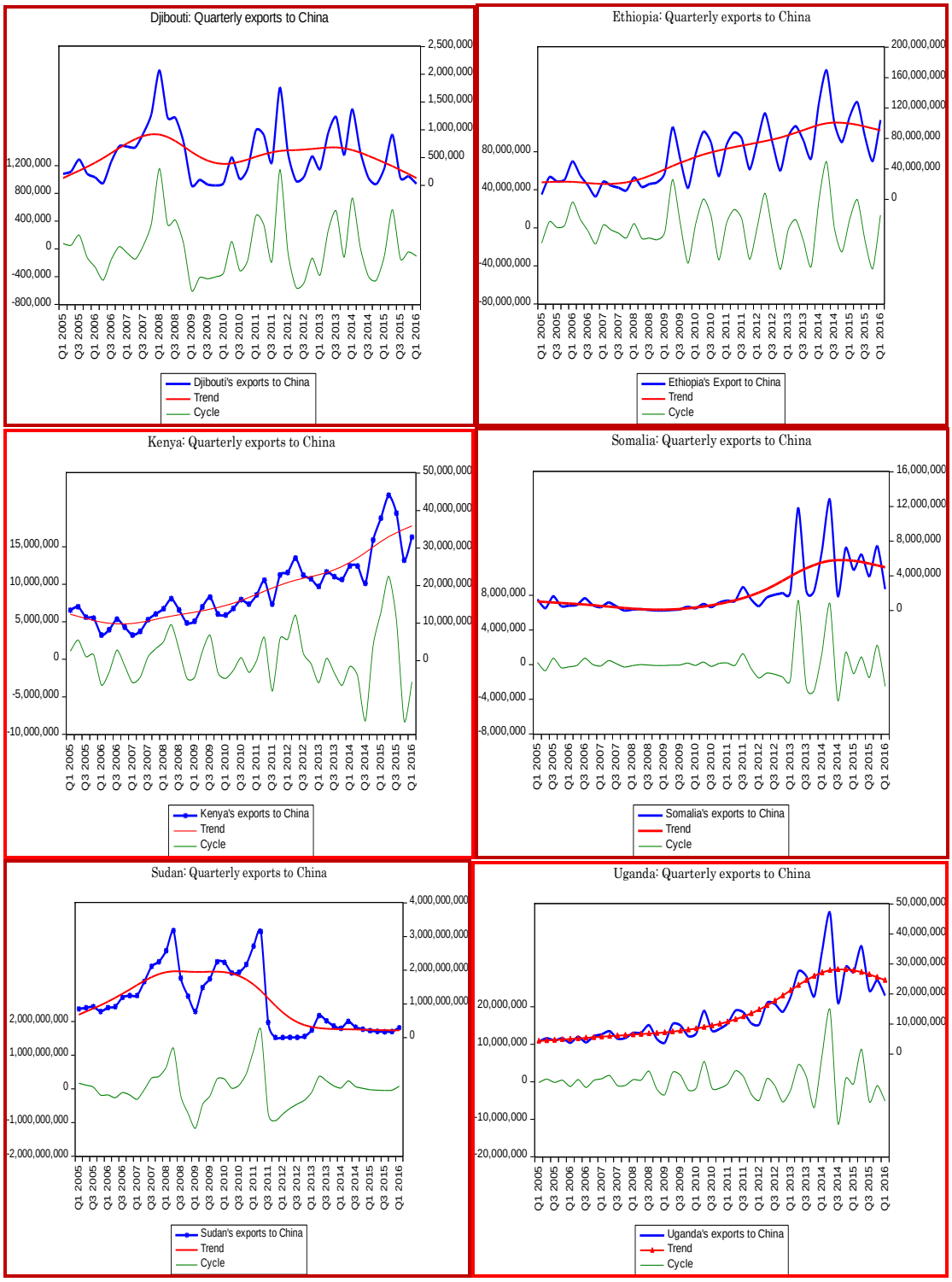
Source: HESPI Computation based on IMF, DOTS (2016)

2.3.3. Does IGAD Exports to China Decline?

IGAD economies exposure to China's economy through trade and investment is significant especially for Ethiopia and Sudan, and Uganda to a lesser extent. The share of IGAD member states' merchandise exports to China ranged between 0.3 percent (Djibouti) to 16.2 percent (Sudan) in 2015. On top the Chinese economic slowdown and rebalancing, global commodity prices (on which most IGAD economies heavily depend on) continue to fall (see appendix). Annual prices for all commodities like tropical beverage, agricultural raw materials, food, minerals and vegetables oil seeds & oil have fallen radically since 2011. The economic slowdown in China and the fall in global commodity price have an adverse impact on IGAD economies exports to China as well as to the rest of World.

Ethiopia and the oil exporting country in the region i.e. Sudan, which have had strong trade ties with China have seen huge drop in their exports to China in 2015 relative to 2014; in 2015, Sudan's exports to China declined by 14 percentage points, while Ethiopia experienced 4 percentage point drop. Figure (15) shows the quarterly exports of IGAD economies to China in 2005/2016. The graph reveals that all economies except Kenya have seen downward trend in quarterly exports to China in recent periods. But Kenya which exports relatively less to China and has diversified exports has been impacted less by the slowdown in China. Djibouti and Sudan's quarterly exports to China has been so volatile. Even though it has had very small trade tie with China, Djibouti has seen downward trend in its exports to China since the first quarter of 2014. Sudan, which had had relatively the largest trade (in exports) with China especially before 2011, has experienced substantial decline in exports to China since 2011 following the South Sudan's secession. On the other hand, the quarterly exports of Ethiopia and Uganda to China has been growing and their trade ties has improved over the years; but they have experienced a decline in their exports to China in 2015. Somalia has also seen a drop in exports to China in 2015.

Fig. 15: Quarterly Merchandise exports of IGAD countries to China



2.4. China's FDI and Finance to IGAD

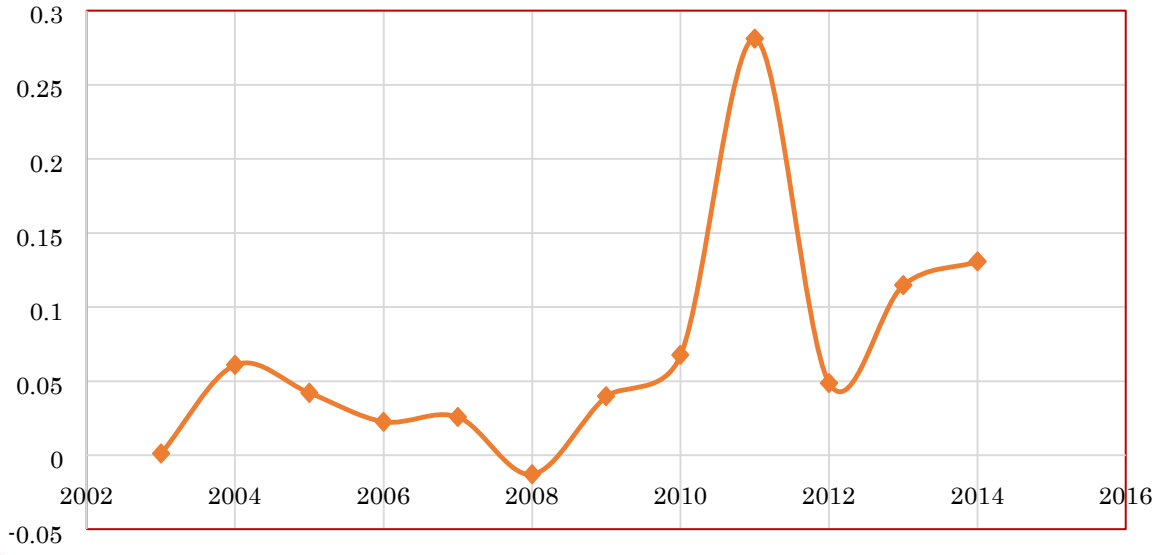
2.4.1. China's FDI in IGAD

Until recently, China's FDI mainly concentrated on mineral sectors in Africa. As late as 2005, half of its investment in Africa concentrated on five major mineral exporters i.e. Angola, Nigeria, South Africa, Sudan and Zambia (Lakatos et al, 2015). That was mainly driven by the huge investment driven demand for energy in China. However, due to the lower demand for energy China's investment in Africa's energy is expected to decline. This is caused by its slowdown and rebalancing from an investment led growth to a consumption led growth. On the other hand, the recent increase in wages and competition within china has also triggered more and more Chinese investors to look for investment destinations elsewhere, particularly in the non-energy sectors. As a result, China's FDI in Africa is expected to change in amount and type in the medium to long term.

As FDI is a major vehicle for technology transfer and source of employment creation, it's imperative to analyze the likely consequences of the slowdown in China and rebalancing on its investment in the IGAD region and highlight on how to best respond to those changes. In what follows, we discuss how the slowdown and rebalancing would affect their investment in IGAD and how IGAD governments should respond to those changes to mitigate negative spillover and attain potential benefits from the new economic opportunities resulted from the changes.

Like in other African regions, China's FDI to IGAD had been relatively modest except in 2011 when it reached close to one-third of IGAD's total FDI mainly due to a temporary boost in its investment in Sudan (see fig. 16) However, it registered a further increase during 2012-2014.

Fig. 16: Chinese share of IGAD FDI

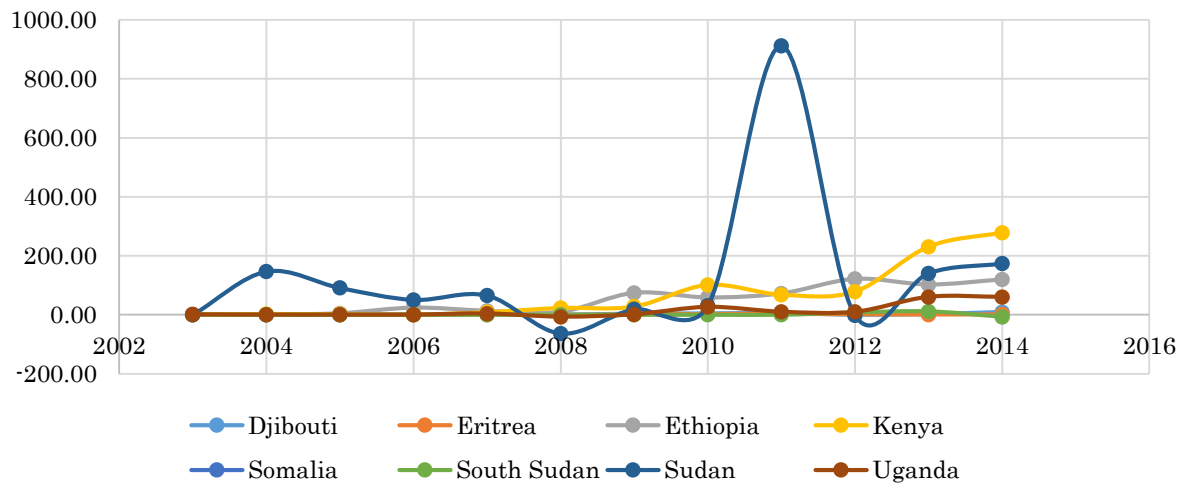


Source: HESPI computation using data from CARI (2016)

Country specific information shows that the flow of FDI from China to IGAD has shown ups and downs during 2003-2014 as Fig. 14 below presents. In Ethiopia, Kenya and Sudan in particular, China FDI inflows increased during 2012-2014. Hence, contrary to expectation that the slowdown in China may cause a decline in FDI to the region, it has actually increased during 2012-2014 period for most of the countries. This is probably owing to the cost competitiveness of the member countries relative to China as noted above.

Furthermore, Chinese firms have different reasons why they choose a specific IGAD country as their investment destination. A recent World Bank survey of Chinese firms operating in Ethiopia revealed that most of the Chinese firms were attracted to invest in Ethiopia due to the cheap labor and land, the large market, and the Chinese and Ethiopian government incentive packages, among other reasons.

Fig. 17: Chinese FDI inflow to IGAD (Millions US $)



Source: HESPI computation using data from CARI (2016)

The slowdown in china is expected to reduce overall demand for IGAD exports, thereby affecting Chinese FDI in IGAD negatively. Likewise the shift in China from an investment led growth to a consumption led growth model also means that there will be less Chinese demand for Africa's oil and minerals. Together with the international price decline for oil and minerals, this means that the appetite of Chinese firms to invest in Africa's oil and mineral sector will decline.

However, the Chinese rebalancing, creating an increasing demand for consumption goods relative to investment goods and change in relative prices, potentially trigger increased investment in IGAD in consumption goods (see also Lakatos et al, 2016). Moreover, the rising wage rate and the recent surge in capital outflow from china reflect an increase in appetite by Chinese investors to seek high returns elsewhere (see also F&D, June 2016)[6]. At the FOCAC 2015 summit, the Chinese government outlined a plan to encourage labor intensive Chinese industries to move to Africa. This is another reason to expect an increasing Chinese FDI in IGAD, where labor cost is among the lowest even by Sub Saharan Africa standards. Hence, in the medium to long term, the net effect of slowdown in China and

[6] Most provinces pay a minimum wage of US$ 239 per month, while others such as Shanghai pay a minimum wage of US$328 in 2016. This is much higher compared to a monthly factory salary of US$ 40 in one of the IGAD countries, Ethiopia in 2016.

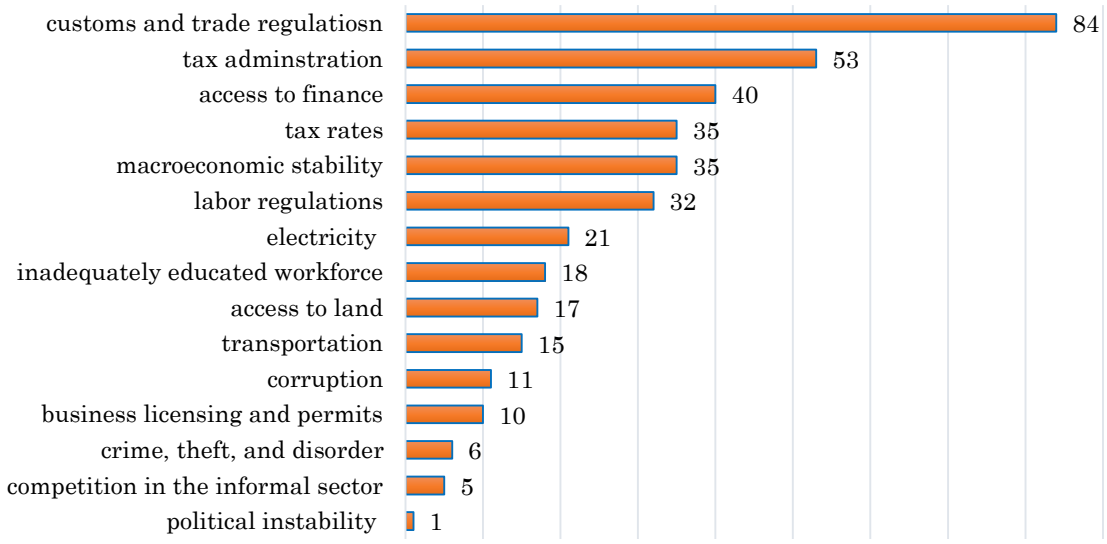
rebalancing is expected to be a higher Chinese FDI in IGAD, where most of the economies are less oil dependent and more diversified than other regions in Sub-Saharan Africa (see also F&D, June 2016). However, this depends on IGAD countries success in creating an enabling environment to attract foreign investors.

Looking forward, in order to attract more FDI from China, IGAD countries need to identify viable investment areas according to their policy priorities and their comparative advantage compared to rival countries. At the most recent FOCAC summit, the Chinese government outlined a list of sectors where it will cooperate to promote Chinese investment in Africa. Among others, these included agriculture, manufacturing, shipping, metallurgy, energy, mining, construction materials, ICT, electricity, rail way, high way, ports and airports. Each IGAD member countries is better positioned than others to attract Chinese FDI in one or more of the above mentioned sectors. This should be supported by a proactive engagement of Chinese industries through higher level of government visits and work of diplomatic missions in china to promote viable investment opportunities in the respective IGAD countries.

Needless to say, IGAD governments have to do much more to improve the business environment in their respective countries to attract FDI in general. Some of the IGAD countries are among the worst performers in the world in the global doing business rankings, even by Sub Saharan African standard.[7] A World Bank survey conducted on Chinese firms in Ethiopia in 2012 reveals that customs and trade regulations, tax administration, and access to finance are the three most common challenges facing Chinese firms in Ethiopia (see Fig. 15). To mitigate this problem, Ethiopia has started building industrial parks that are supposed to provide a one stop service to investors i.e. custom clearance, tax settlement, banking service, and utilities, among other services. Three of the industrial parks, including the one inaugurated in July 2016 at Hawasa city are already in operation. According to Ethiopia's industrial parks development corporation, the country also plans to complete establishment of other 9 industrial parks by the end of the second growth and transformation plan in 2020. As Fig. 15 below also shows, political stability has been one of the major reasons Chinese investors and other international investors choose Ethiopia as their preferred destination. However, the recent sustained protest in some parts of the country are raising eyebrows of investors and Ethiopia has a reason to be concerned. There were even reports that damage was done to some foreign investments. Unless the country solves the current political instability, the status quo will likely continue and the country would lose its position as one of the most politically stable investment destinations in Africa.

[7] Among 50, SSA countries, South Sudan and Eritrea were ranked 49th and 50th in 2015 in ease of doing business.

Fig. 18: Major challenges facing chinese firms in Ethiopia



Source: World Bank Survey (2012)

Likewise, a recent survey of Chinese firms in Kenya reveals that corruption, theft, crime and personal safety are the biggest concern of Chinese investors in Kenya (Sanghi and Johnson, 2016). Hence, Kenya needs to work on those concerns identified by the firms. The other IGAD countries have to identify the major FDI obstacles in their respective countries and aggressively work to tackle them if they are to benefit from the potential FDI from China seeking investment elsewhere outside the country.

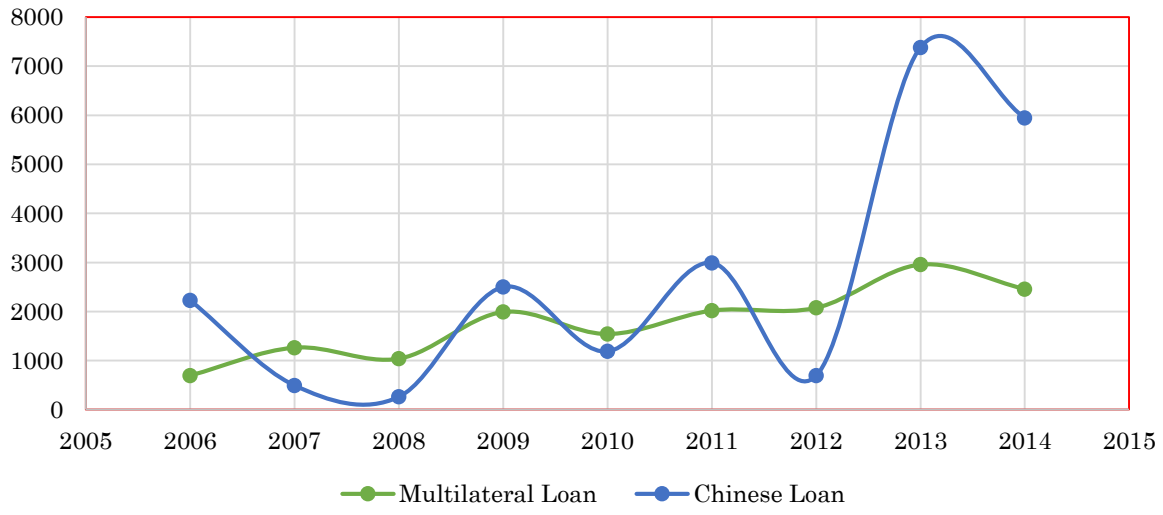
2.4.2. Chinese Finance to IGAD

Loans from China to IGAD, relative to the ODA from OECD, has been relatively smaller until recently. However, it began to be increasingly important since 2008 and exceeds 50 percent of the total ODA in 2013 (see Annex 2)[8].

The significance of loans from China to IGAD is more pronounced when we compare it to the total multilateral loan to the region. Fig. 18 shows Chinese vs multilateral loans the IGAD region received during 2006-2014. One can see that Chinese loans were as important as multilateral loans to IGAD until 2012 and even more important afterwards. Among the total Chinese loans extended to Africa, Ethiopia, Sudan and Kenya stand as the 2nd, 3rd and 4th largest recipients during 2000-2014 (CARI, 2016).

[8] ODA constitutes concessional loans and grants by development agencies of OECD and non OECD countries, and multilateral agencies.

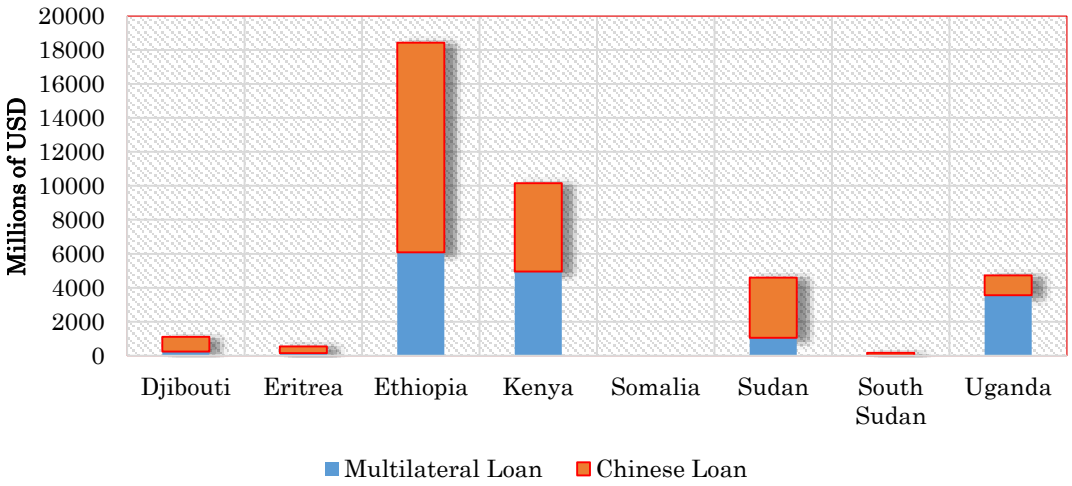
Fig. 19: Chinese VS Multilateral Loan to IGAD (Millions US $)



Source: OECD (2016) and CARI (2016)

Country specific data within IGAD also shows that most of the countries in the region have received more loans from china than multilateral donors during 2006-2014, except Uganda where Chinese loans were a fraction of the total multilateral loans (see Figure 20).

Fig. 20: Chinese VS Multilateral Loans (2006-2014)



Source: HESPI computation using data from CARI and OECD.

Contrary to common belief, Chinese loans are provided to countries regardless of whether the recipient is resource rich. Concessional aid is given depending on ability to pay. As of 2009, 61% of concessional loans was provided to finance infrastructure projects while 16% of the loans was used to finance industrial development (Lakatos et al, 2016). Most of the projects are financed by the Chinese EXIM bank and to some extent the development bank of china. The loans are meant to promote Chinese exports and investments abroad by providing international guarantees on behalf of Chinese firms, and providing export seller credit and export buyer credit (center for Global Development 2006). Although

some argue that the Chinese EXIM bank provides loans using commodity export as guarantee, this happened to handful of resource rich countries such as Angola, Congo Kinshasa (see also CARI, 2016).

The slowdown in china will arguably cause a decline in loans available to IGAD countries. Moreover, to the extent that Chinese loans have been financing some investments in the oil sector in IGAD, Chinese rebalancing causes a decline in loans available to finance similar investments due to low demand for energy in china. However, contrary to expectations, the Forum on China-Africa cooperation (FOCAC) pledged a US$ 60 billion fund, of which US$ 35 billion is for concessional loans and export credit. [9] The committed amount triples the credit line to Africa that China declared on FOCAC Summit 2012 (see FOCAC, 2015). Unlike the expectation that china's slow down and rebalancing will lead to lower Chinese finance to Africa, this pledge signals that there will be a significant increase in Chinese finance to Africa during 2015-2018. However, IGAD countries need to identify viable investment projects in order to tap in to the increasingly available Chinese finance to Africa. The Chinese rebalancing means that viable projects should focus less on oil and other mineral investments. At the FOCAD (2015) summit in Johannesburg, it was outlined that the Chinese financial institutions will provide finance and insurance support for china-Africa cooperation in agriculture, processing manufacturing, shipping, metallurgy, energy, mining, construction materials, information and communication technology, electricity, railway, highways, ports and airports. Hence, IGAD governments need to identify viable investment projects according to their comparative advantages within the above mentioned sectors in order to tap in to the significant Chinese fund made available to finance projects in Africa.

The obvious policy implication is that what is the likelihood and the ease with which IGAD member countries could diversify their export destinations to make up for any loss if the slowdown in the Chinese economy persists? Given the 'appetite' that the Chinese economy has shown for raw materials and for unprocessed goods and its directed trade links with the countries, any long-term decline in the demand for IGAD imports by China is likely to have appreciable negative impact even if ultimately they get alternative markets. This is in addition to the active collaboration in the areas infrastructure, bank loans and other support that has actively boosted the economies of at least some countries in IGAD.

[9] FOCAC (2015) allocates the remaining amount as follows: US$ 5 billion for aid grant and interest free loans; US$ 5 billion for investment augmentation in to the China-Africa development fund; US$ 10 billion to the foundation of the China-Africa Cooperation fund.

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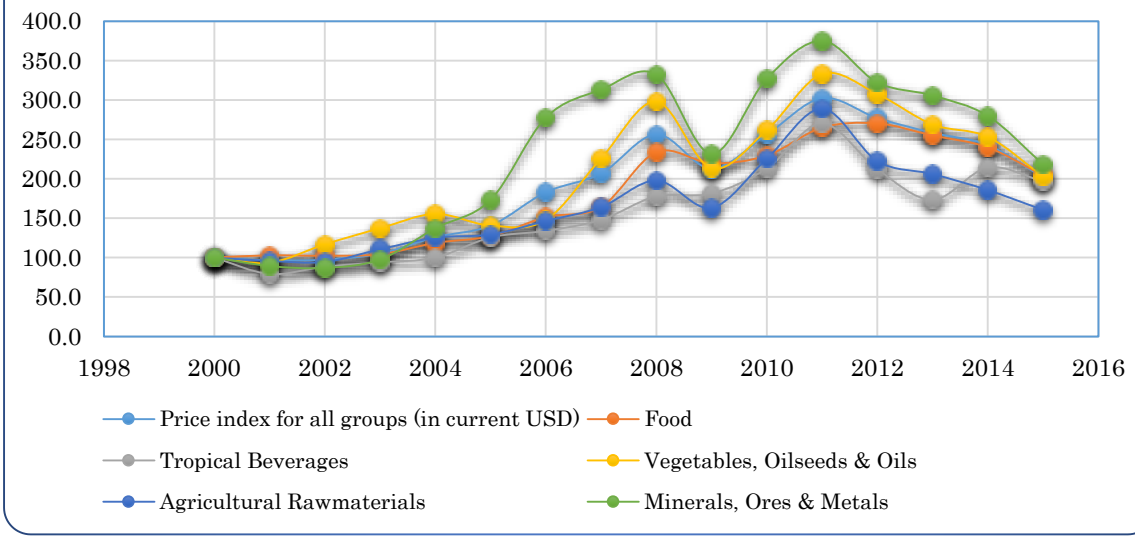
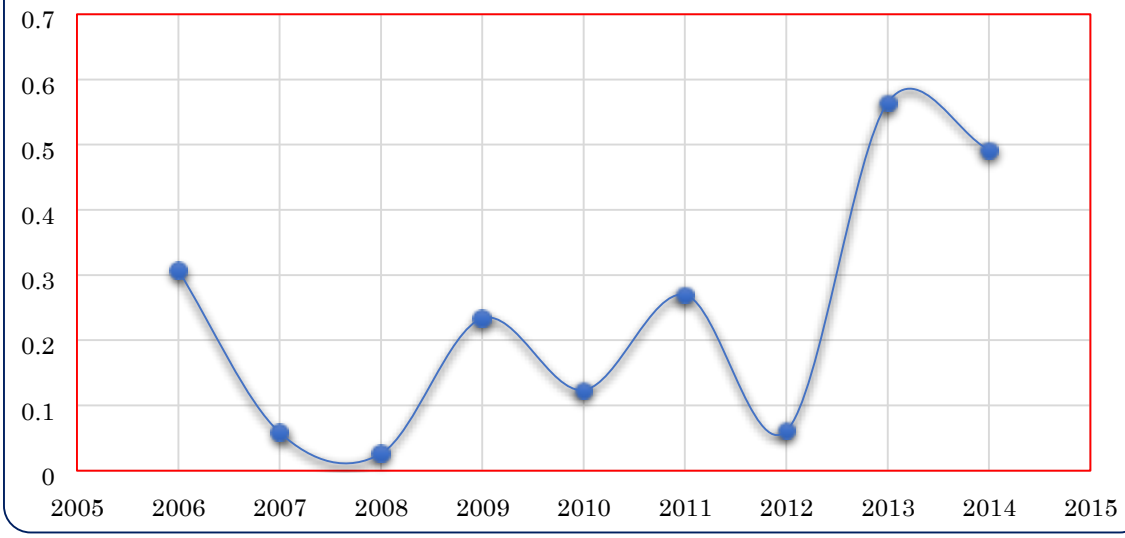
ANNEXES

Annex 1: Annual commodity price index for selected commodities (2000=100)



Source: UNCTADstat (2016)

Annex 2: Chinese Loans to IGAD as Share of total ODA



Source: WDI (2016) and CARI

Annex 3: Five Year Regional Population Forecast (2015-2050), in Thousands

	2015	2020*	2025*	2030*	2035*	2040*	2045*	2050*
Djibouti	975	1065	1166	1,262	1,356	1,447	1,535	1,619
Eritrea	6,077	6,848	7,613	8,394	9,207	10,032	10,829	11,567
Ethiopia	91.999	101,046	109,969	118,514	126,392	133,466	139,729	145,187
Kenya	46,332	52,563	59,054	65,928	73,257	80,975	88,907	96,887
Somalia	10,606	12,237	14,152	16,359	18,865	21,868	24,762	28,217
South Sudan	12,340	14,122	15,951	17,810	19,747	21,744	23,786	25,855
Sudan	49,071	54,919	60,811	66,856	72,961	79,055	85,082	90,961
Uganda	39,112	45,423	52,330	59,846	67,922	76,437	85,250	94,259
IGAD	164,605	288,223	321,046	354,969	389,707	425,024	459,880	494,552
SSA	967,356	1,088,812	1,217,548	1,353,772	1,497,268	1,647,277	1,802,244	1,960,102
IGAD-% of SSA	17	26.5	26.4	26.2	26	25.8	25.5	25.2

Source: http://www.recordmeteo.com/population/

*Forecast

Annex 4: FDI Inflows to IGAD Economies, 1990-2015

	Djibouti	Eritrea	Ethiopia	Kenya	South Sudan	Sudan	Somalia	Uganda
1990	0.1	0.0	12.0	57.1		- 31.1	5.6	- 5.9
1991	2.3	0.0	6.0	18.8		- 0.6	- 0.2	1.0
1992	2.3	0.0	0.2	6.0		0.1	- 0.1	3.0
1993	1.4	0.0	3.5	2.0		- 0.2	2.0	54.6
1994	1.4	0.0	17.2	4.3		99.2	1.0	88.2
1995	3.2	0.0	14.1	33.0		12.0	1.0	124.5
1996	3.3	36.7	21.9	10.5		0.4	1.3	121.5
1997	3.1	41.1	288.5	53.0		97.9	1.1	141.5
1998	3.2	148.5	260.7	11.4		370.7	0.0	132.6
1999	3.2	83.2	70.0	13.8		370.8	- 0.8	140.2
2000	3.3	27.9	134.6	110.9		392.2	0.3	180.8
2001	3.4	12.1	349.4	5.3		574.0	0.0	151.5
2002	3.4	22.8	255.0	27.6		713.2	0.1	184.6
2003	14.2	25.0	465.0	81.7		1 349.2	- 0.9	202.2
2004	38.5	24.1	545.1	46.1		1 511.1	- 4.8	295.4
2005	22.2	1.4	265.1	21.2		1 617.1	24.0	379.8
2006	108.3	15.4	545.3	50.7		1 841.8	96.0	644.3
2007	195.4	7.2	222.0	729.1		1 504.4	141.0	792.3
2008	228.9	39.0	108.5	95.6		1 653.1	87.0	728.9
2009	74.7	91.0	221.5	115.0		1 726.3	108.0	841.6
2010	36.5	91.0	288.3	178.1		2 063.7	112.0	543.9
2011	79.0	39.0	626.5	335.2		1 734.4	102.0	894.3
2012	110.0	41.4	278.6	258.6	161.0	2 311.0	107.3	1 205.4
2013	286.0	43.9	1 281.3	514.4	793.0	1 687.9	446.0	1 096.0
2014	153.0	46.5	2 132.0	1 050.7	419.0	1 251.3	434.0	1 058.6
2015	124.0	49.3	2 167.6	1 437.0	277.0	1 736.8	516.0	1 057.3

Source: UNCTAD (2016)

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