POLICY BRIEFING 10

China in Africa Project

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Chinese Investment in African Free Trade Zones: Lessons from Nigeria's Experience

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RECOMMENDATIONS

- African governments need to show political commitment at the highest level to free trade zones (FTZs) for these FTZs to succeed.
- Technology transfer should be a core objective for African governments negotiating agreements with Chinese investors for FTZs.
- To maximise the prospects of technology transfer from Chinese investors in FTZs, African governments should not only make clear, achievable demands of these investors during negotiations, but also take steps to improve the overall business climate in which the negotiations are taking place.
- African governments should not offer potential Chinese investors in FTZs over-generous terms, even if they are the only prospective investors, but must also recognise that the riskier the business climate, the greater the leverage investors have to dictate terms.

EXECUTIVE SUMMARY

Nigeria's free trade zone (FTZ) legislation has been in place for 17 years, but progress in implementation has been uneven and slow. The main FTZ in which Chinese companies play a significant role is the Lekki Free Trade Zone (LFTZ), where work began in 2006. A Chinese consortium led by the China Civil Engineering Construction Company holds a majority stake in the Lekki Free Zone Development Company (LFZDC), which has a 50-year lease on the site. The first phase of development is due for completion in 2014, at an estimated cost of $700–800 million. The LFZDC has faced major difficulties, including a dispute within the Chinese consortium and a continuing lack of certainty about its power supply, but enjoys strong support from the Lagos State governor, Babatunde Fashola, and construction is pushing ahead.

A number of lessons can be derived from the LFZDC's experience, including the need for greater confidence in negotiating with potential Chinese investors, even in cases where countries have a high-risk profile. Finally, it is clear that the more promising the business climate, the greater the prospect of technology transfer from Chinese investors, increasing the overall benefit to the host country.

FREE TRADE ZONES IN NIGERIA

The Nigeria Export Processing Zones Authority (NEPZA), with the power to license, monitor and regulate tax-exempted FTZs, was established in 1992 during the rule of Major-General Ibrahim Babangida. Investors in Nigeria's FTZs are promised a 'complete tax holiday'; one-stop approvals for all permits and licences; duty-free imports; permission to sell everything made in the zones to the domestic market; 100% foreign ownership of investments; 100% repatriation of capital, profits and dividends; and a prohibition on strikes and lock-outs.[2] Yet, because of the uncertainties surrounding governance and the country's infrastructural weaknesses, particularly concerning power generation, international investor take-up of these generous incentives has been low.

CHINESE INVESTMENT IN NIGERIAN FREE TRADE ZONES

The first FTZ where Chinese companies have had a significant stake is the LFTZ near Lagos. The LFTZ is a 16 500-hectare area, about 60 kilometres east of central Lagos, and was identified for development by the Lagos State government (LSG) in 2005. The LSG had originally hoped to identify Western companies prepared to join it in a consortium to develop the site, but failed to do so. It then 'looked East' and in April 2006, via a new company wholly owned by the LSG called Lekki Worldwide Investments (LWI), formed a joint venture, Lekki Free Zone Development Company (LFZDC), with a Chinese consortium. The Chinese consortium holds 60% of LFZDC, LWI holds 20%, and 20% has been left for Nigerian investors.[3]

The second FTZ where China has invested is the Ogun Guangdong Free Trade Zone (OGFTZ), in Igbesa, Ogun State, which in mid-2009 was at the site clearance stage. The OGFTZ is run by a joint venture between the Ogun State government and a Chinese consortium called the China African Investment Company, which was approved by the NEPZA in mid-2008.[4] The Ogun State government has an 18% stake in the joint venture, and the China African Investment Company, which is led by China's Guangdong, has the balance, plus 100% management control and a 100-year concession for the OGFTZ.[5]

THE LEKKI FREE TRADE ZONE

The LSG and Chinese consortium agreed in 2006 that the consortium would invest $200 million in the LFTZ, while the LSG would arrange the licence, provide the land, move and compensate displaced villagers, and identify Nigerian investors to provide an additional $67 million. The LSG had apparently been under the impression that all the Chinese consortium's money would be delivered up front, but the contract did not specify that, and this was not how the consortium proceeded. Instead, as of April 2009, the consortium was said to have provided only $50 million in cash and kind for the project, while no money has been forthcoming from Nigerian investors. The lack of Nigerian investment has obliged the LSG to step in, and $67 million has been allocated to the LFTZ in the state's 2009 budget.[6]

The LFTZ experienced difficulties in late 2008 due to conflicts within the Chinese consortium. One of the main consortium members, the China Civil Engineering Construction Corporation (CCECC), which is the second-largest construction company in Nigeria, had assumed it would handle the bulk of the LFTZ's construction needs. Instead, however, another consortium member, Nanjing Jiangning Economic and Technical Development Zone (Nanjing), appropriated more and more of the task of completing the first 1 000-hectare development phase. Concerned that the quality of the work being carried out might suffer, the LSG lodged a formal complaint, halting work on the project and demanding that CCECC return. The Chinese government then intervened and unilaterally restructured the Chinese consortium in CCECC's favour. The Chinese government also brought in a new investment partner, the China–Africa Development Fund, which is managed by the China Development Bank. This satisfied the LSG and construction work resumed, this time carried out by CCECC, in early 2009.[7]

Work during the first half of 2009, before the arrival of seasonal rains halted most construction, was slow going, since the land is boggy and has required extensive filling.[8] In April 2009 phase I was scheduled for completion in 2014.[9] Total investment for the phase was scheduled to run to $700–800 million, with the idea being to spend the initial $267 million getting to the point where LFZDC has a bankable project for which it can seek financing. The China–Africa Development Fund is said to be interested in contributing a significant proportion of these funds.

A major challenge is securing a reliable power supply for the LFTZ. LFZDC's plan is to construct a gas turbine power plant, but neither it nor the Lagos FTZ has yet resolved the issue of where to access the gas. Running a pipeline from the violent and troubled Niger Delta region has problematic security implications, and LFZDC has said it is exploring alternative energy sources. In the meantime, however, LFZDC is running expensive diesel generators to power its construction programme.[10]

Despite the challenges, LFZDC has the considerable benefit of strong political support. Like his predecessor, the present Lagos State governor, Babatunde Fashola, is strongly behind the FTZ and made it a central part of his election manifesto. Less clear, perhaps, is the enthusiasm of the Chinese consortium for the project, which has been alleged by some involved to have waned since the disagreements of late 2008.[11]

LESSONS FROM THE LEKKI FREE TRADE ZONE

When a country has a high-risk profile, this gives investors powerful leverage to dictate terms.

A major constraint for the LSG, other state governments and the federal authorities is that for as long as Nigeria is perceived as a high-risk investment destination, they will always struggle to secure agreements with investors in sectors beyond the offshore oil and gas industry. This means that investors, such as Chinese companies, that are prepared to risk investing in these sectors will enjoy strong leverage, enabling them to continue to impose terms that are decidedly suboptimal from the Nigerian point of view.

Lack of confidence can lead to African governments offering Chinese investors over-generous deals.

The original agreement between the LSG and the Chinese consortium gave LFZDC, which is 60% owned by the Chinese consortium, the exclusive right for 50 years to develop a massive, 16 500-hectare site for a payment of just $200 million, without even the stipulation that all the money be delivered up front. The reason for these terms was, firstly, the lack of interest in Lekki from any investors apart from the Chinese and, secondly, the LSG's inexperience in establishing and running an FTZ. An LSG representative said that the state government now recognises that not only was the original agreement far too generous, but it was also unworkable, since at the current pace of construction, for LFZDC to develop the whole site would take 30 years.[12] The agreement has since been renegotiated, allocating LFZDC just a 3 000-hectare site within the 16 500-hectare total and creating the space for the LSG to invite in other investors to handle other parts of the site. Another issue that has been renegotiated since the original agreement concerns the number of Chinese workers employed by LFZDC. Initially, it appears, there were no restrictions on this, and the result was that Chinese companies imported and employed mostly Chinese workers, much to the resentment of local Nigerians. Since then, a local content agreement has been negotiated, which guarantees that a minimum of 40% of the LFZDC workforce must be Nigerian and that any work that can be performed by Nigerians must be. As a result, many among the Chinese workforce have been sent home. The LSG representative in LFZDC has commented that while the new agreement is still not perfect, it is much better than the old one, and that the LSG will handle negotiations with other prospective partners more confidently and assertively in the future.

The LFTZ illustrates the complex interplay between Chinese companies and the Chinese government.

The Chinese government is adamant that Chinese companies are encouraged to compete with one another at home and in foreign markets. Nigeria's experience suggests that this is indeed the case, particularly in telecommunications and construction. Yet the LFTZ's experience offers an indication of the limits of the Chinese government's free market stance. When Nanjing moved aggressively to appropriate as much of the LFTZ work for itself as it could, to CCECC's detriment, Beijing firmly intervened, forcing a restructuring of the consortium to give CCECC a stronger role, increasing its stake from 25% of the consortium to 75%. The Chinese government's intervention was largely motivated by the LSG's complaints, illustrating the importance Beijing attaches to maintaining good political relations in the Lekki project. Another factor was that the LSG's main stated concern was the implications of Nanjing's increased role for the quality of the consortium's work. Chinese companies are often criticised internationally for poor-quality workmanship and it seems that another reason for the intervention was that the Chinese government wants to improve this image.

CONCLUSION

Nigeria's experience of Chinese investment in FTZs shows that appropriate enabling legislation from the state is just the beginning of the process. The success of the FTZs also requires:

- political commitment at the highest level;
- proper implementation of the regulatory framework;
- a confident negotiating stance with Chinese investors, including firm requirements and timelines concerning technology transfer; and
- a conducive business climate, including adequate infrastructure.

LFZDC enjoys some, but not all, of these conditions and, as a result, its success, while still entirely possible, is by no means guaranteed. Some sceptics have said that Chinese companies are only interested in LFZDC construction contracts and not in establishing an enduring manufacturing presence in the zone. Yet the Mauritian experience suggests that when the operational environment is conducive, Chinese companies are prepared to invest in manufacturing and the transfer of technology. The Nigerian authorities' challenge if they wish to achieve the same result is to continue the difficult, but ultimately rewarding, work they have started of shaping this environment.

ENDNOTES

1 Gregory Mthembu-Salter is a researcher, author and journalist on Africa's political economy, and has served on the UN Panel of Experts on the Democratic Republic of Congo.
2 NEPZA (Nigeria Export Processing Zone Authority), <http://www.nepza.gov.ng/>.
3 Interview with senior official, LFZDC, Lagos, April 2009.
4 *Leadership*, 'Nigeria: Ogun govt, Chinese consortium partner on free trade zone', 11 June 2008, <http://allafrica.com/stories/200806110607.html>.
5 Interview with senior official, LFZDC, Lagos, April 2009.
6 *Ibid.*
7 *Ibid.*
8 Interview with LFZDC engineer, Lekki, April 2009.
9 Interview with Allen Lee, managing director, LFZDC, Lagos, April 2009.
10 Interview with senior official, LFZDC, Lagos, April 2009.
11 Interview with senior LWI officials, Lagos, April 2009.
12 Interview with senior LFZDC official, Lagos, April 2009.

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