

## THE BENEFITS AND BURDEN OF CHINESE FOREIGN DIRECT INVESTMENT IN EAST AFRICA

### KEY POLICY MESSAGES:

1. China's trade and economic relationship with East Africa countries brought in much needed aid and Foreign Direct Investment (FDI) in infrastructure projects which would otherwise be too costly for these developing countries, and contributed to construction and development boom. It has made possible for some countries in the sub-region to grow their internal consumer market, generate some new opportunities for jobs and economic growth.
2. Despite the positive aspects of China's FDI, there are some serious concerns of the interplay between China's foreign policy, aid and unconditional loans to East African countries. China's lax lending practices, dubbed as "debt-book diplomacy", could reel East African countries in a vicious circle of long-term indebtedness, fiscal deficit, spending cuts and politico-economic dependence on China.
3. Chinese investment should spawn practical knowledge and technology transfer to the East African countries to sustain the growth, development and industrialization of the region.
4. China – East Africa cooperation needs to address the environmental impact of Chinese trade and investment in the extractive, manufacturing, agriculture and fishing sectors in the region.
5. Somalia could benefit from China's FDI in infrastructure projects such as the rehabilitation and expansion of airports, ports and roads but should negotiate formal, transparent, mutually beneficial trade and economic cooperation agreement with China.
6. The World Bank has to play a greater role in helping the East Africa region to attract more investment to spur further economic growth through its MIGA, extending political risk insurance and credit enhancement for investors and lenders in East Africa region on par with the favourable insurance policies of Chinese insurers.
7. There is a need to develop globally adaptable "Consensus" of economic systems tailored to stimulate sustainable economic growth and development in Africa, one which charts a middle ground between the "prescriptive and excessive conditionality" of the World Bank and IMF and "non-conditionality laissez-faire lending approach" of China.
8. There is a need for optimum feasibility studies on projects impact on people and the environment in China's future investment plans and negotiations in the region.



This work is licensed under a Creative Commons Attribution—Non Commercial License (CC BY-NC 4.0) Attribute to: Somali Institute for Development Research and Analysis

## 1. INTRODUCTION

### Beginning:

China began its engagement with Africa in the middle of 1950s, seeking to cultivate political alliances against Western imperialism and hegemony. Somalia indeed was the first country in East Africa region to establish official diplomatic relations with China in 1963.

Historians date the first human contact between China and East Africa over two thousand years ago. Archaeological and historical evidence shows contact and trade relationship between China and East Africa region in 8th century during the Tangy dynasty (1). Admiral Zheng He's well-documented expeditions across the Indian Ocean have reached the East Africa coast in 14th Century, visiting Mogadishu in Somalia and Malindi in Kenya (2).

In the contemporary Sino-African history, China began its engagement with Africa in the middle of 1950s, seeking to cultivate political alliances against Western imperialism and hegemony. China played an important role in the independence movement in Africa which led to the newly independent African nations actively supporting the efforts of the People's Republic of China to join the United Nation and represent all the people of China, including Taiwan. Somalia indeed was the first country in East Africa region to establish official diplomatic relations with China in 1963, soon after its independence in 1960 and sign the first Sino-Somali trade agreement (3).

China claims that its aid, investment and economic cooperation are modelled around its foreign policy of peaceful co-existence, respect of sovereignty and political independence, multilateralism and cooperation. Over the last 20 years, China has significantly increased its presence and outbound Foreign Direct Investment (FDI) in Africa, making it the third largest investor in Africa after the United States and European Union. This apparent proliferation of China's FDI in Africa has received considerable attention and mixed reactions in recent years. Scholars argue that China's *raison d'être* in Africa is primarily driven by China's need for new market opportunities, its acquisitive pursuit of critical natural resources and its long-term politico-economic strategy to become leading global power.

China has sponsored the second Belt and Road Initiative (BRI) Forum meeting on 25 – 27 April 2019 in Beijing for leaders and delegates from more than 150 countries. Under the BRI plans, China has committed around US 1 trillion of funding, expertise and technology in a network of major infrastructure projects connecting Asia, the Middle East, Africa and Europe with a vision of unobstructed trade, advanced global infrastructure connectivity, financial support, multilateral cooperation and people to people exchange (4). Somalia was the last country in the East Africa region to get involved in the BRI and only signed up to the initiative in 2018.

The East Africa region, in particular, is very attractive to China due to its geographical location, its growing consumer market, cheap labour costs and the abundance of natural resources. Moreover, East Africa contains some of the fastest growing and most buoyant economies in Africa. In 2018/19, the projected growth of Ethiopia, Kenya, Tanzania and Uganda stand around 5 - 6% in the financial year (5).

The region is exceptional in its relationship with China as it hosts China's first overseas military base in Djibouti. For the first time in modern China history, China has deployed its navy outside its territorial waters to take part in the international counter-piracy operations off the coast of Somalia alongside EU Navfor, Australia, US, India and Iran. Another notable example is Ethiopia, the fifth largest recipient of Chinese FDI in Africa, which attracted millions of Chinese aid and investment in ambitious infrastructure projects such as Ethio-Djibouti Railway, the Addis Ababa ring road, modern Ethiopian Airline storage facilities, and African Union Headquarters in Addis Ababa to mention but a few. Kenya and Tanzania feature among the top 15 China's FDI African beneficiaries.

### East Africa and China:

The East Africa region, in particular, is very attractive to China. East Africa contains some of the fastest growing and most buoyant economies in Africa. In 2018/19, the projected growth of Ethiopia, Kenya, Tanzania and Uganda stand around 5 - 6% in the financial year.

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).

China's presence in Ethiopia and Djibouti and the envisioned 21st Maritime Silk Road, a component of BRI, form 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 ultimately gain unfettered access to European markets.

## 2. CHINA'S FDI – POSITIVE AND ADVERSE IMPLICATIONS

### Non-conditional loans:

Could burden the region with enormous debt and set back the political, economic and market reforms needed to stabilize and grow their economies. Seven East African countries feature in the top 50 heavily indebted countries to China.

China's emergence as global economy power and its development and foreign relations approach is generally perceived positively in many African countries. Some observers emphasize China's reciprocal 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 rather than that of an aspiring neo-colonial hegemon" (6).

perception that "Chinese state-driven lending, similar to any rising economic powers, is shaped by geopolitical objectives to tap into new markets abroad, to secure commodity imports and to further its global ambitions" (7).

It is suggested that China's non-conditional loans could burden the region with enormous debt and set back the political, economic and market reforms needed to stabilise and grow their economies. According to World Bank, as many as 18 nations in Africa are at risk of debt distress. Seven East African countries feature in the top 50 heavily indebted countries to China. China is the single largest lender to these countries, possessing around 20% of their external debt (8).

### Less Risk:

Chinese investors are less worried about risks from political, social and environmental conditions, lack of compensatory frameworks and public good in Africa than their Western counterparts, hence the relaxed but measured approach of investing in and offering large sums of loans to these East Africa countries.

It is evident that China's engagement in East Africa brought in much needed aid and Foreign Direct Investment (FDI) in infrastructure projects which would otherwise be too costly for these developing countries. China also supported the region to grow their internal consumer market, generate new opportunities for jobs, economic growth and development, better health and living standards and other social benefits.

It is suggested that Chinese investors are less worried about risks from political, social and environmental conditions, lack of compensatory frameworks and public good in Africa than their Western counterparts, hence the relaxed but measured approach of investing in and offering large sums of loans to these East Africa countries.

Despite the positive aspects of China's FDI, some African scholars cast suspicion on the interplay between China's foreign policy, aid and FDI. Horn et al (2019) concur with the increasingly common

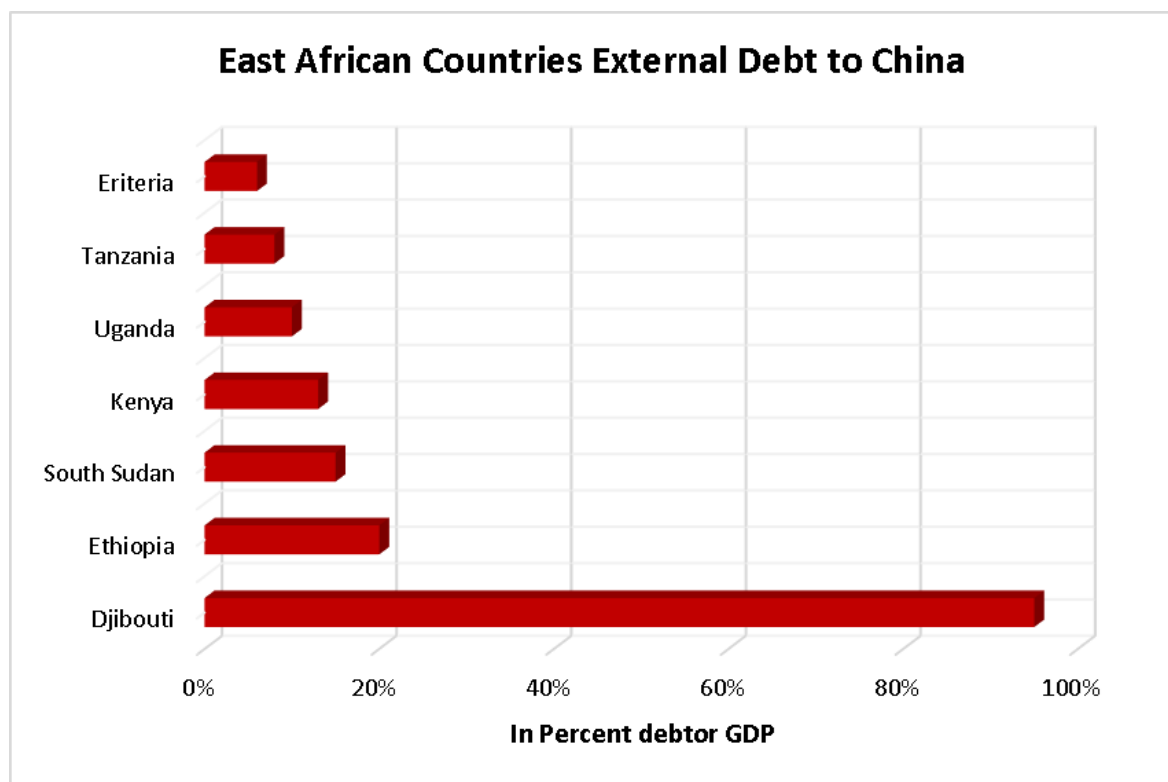
For instance, Ethiopia's indebtedness to China is projected to be more than 10 billion dollars, ratcheting up its total external debt to 59% of its Gross Domestic Products, (8, 9). Djibouti President Ismail Omar Guelleh's signature Vision 2035 to transform Djibouti into a logistical and commercial centre for continental trade is financed with around 2 billion dollars of loans from China's Exim Bank, making Djibouti the most indebted county to China in terms of per GDP, nearly 95% of its GDP (8). The graph below adapted from Horn et al shows direct Chinese loans as a measure of the debtor GDP.

**Alarm:**

African scholars are alarmed about the mounting debt to China, which could risk the takeover of strategic facilities and key assets by China as the case in Sri Lanka demonstrates. Such genuine fear has forced the Ethiopian Prime Minister to request China to renegotiate the terms and repayment conditions of its loan obligations.

**Concerns:**

There is some concern of China’s negotiation tactics of offering loans to countries in East Africa in exchange for natural resources, ensnaring them to acquiesce exclusive rights to Chinese companies to extract minerals in quantities that could far exceed the value of the loans or the cost of the projects.



Source: Adapted from Horn et al, KIEL Working Paper and China’s Overseas Lending.

While Chinese leaders downplay any surreptitious motives of influence, evidence shows that China is capitalising on its “diplomacy” to expand its trade, secure access to resources, and to influence foreign policies of host countries. African scholars are alarmed about the mounting debt to China, which could risk the takeover of strategic facilities and key assets by China as the case in Sri Lanka demonstrates. Such genuine fear has forced the Ethiopian Prime Minister to request China to renegotiate the terms and repayment conditions of its loan obligations.

However, there are signs that China is tightening its investment policies and “no strings attached” loans in infrastructure projects of grand scale in Africa. In a recent Belt and Road Initiative Forum in Beijing, China’s President Xi Jinping warned against what he called “vanity projects,” a tacit reference to and disapproval of costly and unsustainable

infrastructure projects and unrepayable loans.

There is some concern of China’s negotiation tactics of offering loans to countries in East Africa in exchange for natural resources, ensnaring them to acquiesce exclusive rights to Chinese companies to extract minerals in quantities that could far exceed the value of the loans or the cost of the projects. Observers also agree on the overall lack of robust feasibility studies, cost–benefit analysis and environmental impact assessments on Chinese FDI in big infrastructure projects prior to loan agreements.

## Recent Studies

Horn, Reinbart and Trebesch (2019) described the opaque nature of Chinese lending practices and its lack of reporting which “makes it very challenging to do rigorous empirical work on China’s official capital exports.” They stated that “the People’s Bank of China (PBoC) does not publish its sovereign bond purchases or the composition of its portfolio.

Scholars highlight the selectivity and geographical concentration of Chinese investment activities in Africa’s resource rich countries such as Nigeria, Sudan, Angola, Mozambique, Kenya, Zambia, South Africa, and Ethiopia. A quantitative study by Kolstad and Wing (2011) supported “the commonly made observation that Chinese investment in Africa is primarily resource-seeking, particularly resources located in poorly governed countries.” They were, however, balanced in their conclusion to indicate that it is not only China that is guilty of resource-based cooperation but “exploiting resources and weak institutions appears to be the name of the investment game in Africa, (10)”.

China lacks concerns about claims that socio-political and environmental consequences of its FDI and its close relationship with undemocratic some regimes could be detrimental to long-term development of sound political governance, institutional capacity and

promotion of human rights in East Africa. Notwithstanding, recent studies did not implicate China FDI in propping up undemocratic regimes, conclusions were however drawn to show that “China is attracted by institutional insufficiency in Africa (11)”.

The lack of reporting and other difficulties to study China’s FDI is echoed in a number of recent research studies. Horn, Reinbart and Trebesch (2019) described, on top of chronic underreporting of international debt statistics generally, the opaque nature of Chinese lending practices and its lack of reporting which “makes it very challenging to do rigorous empirical work on China’s official capital exports.” They stated that “the People’s Bank of China (PBoC) does not publish its sovereign bond purchases or the composition of its portfolio. Similarly, China does not provide details on its “Belt and Road” initiative and its direct lending activities (7)”.

## Agreements:

In 2018, the Federal Government of Somalia entered fishing agreement with a consortium of 31 Chinese fishing vessels, giving them the fishing rights of Tuna and Tuna-like species in Somali waters for an annual fee of \$35, 000 each.

Despite its diplomatic presence in Somalia since 1960, China became more actively engaged in Somalia following the expulsion of Soviet diplomatic and military advisors from the country in 1977 Somali-Ethiopian war. Despite the absence of records of Chinese aid projects in Somalia due to the destruction of most official records over the course of Somali civil war, there is evidence of Chinese aid to Somalia in many essential infrastructure projects between 1970 and 1990, notably the construction of roads, Somali National Theatre and Mogadishu Stadium.

Somali observers posit that China has not made any significant engagements in to peace and state building efforts in Somalia in the last 28 years of civil strife, state fragility and ineffective state institutions. In 2018, the Federal Government of Somalia entered fishing agreement with a

consortium of 31 Chinese fishing vessels, giving them the fishing rights of Tuna and Tuna-like species in Somali waters for an annual fee of \$35, 000 each. Many Somalis have expressed grave concerns about the agreement and the secrecy surrounding it, typical of agreements signed with China in other parts of East Africa, (12) and the fact that Chinese companies may be gearing up to pursue other trade and investment opportunities in Somalia, taking advantage of the weak and ineffective institutional governance in Somalia.

## 3. CHINA FDI AND SOMALIA’S FRAGILITY AND INVESTMENT OPPORTUNITIES

## Benefits:

Somalia could benefit from Chinese FDI in infrastructure projects such as the rehabilitation and expansion of airports, ports and roads.

Despite the inability of the Federal Government of Somalia, grappling with widespread insecurity, state fragility and weak economy, to formulate coherent foreign and economic policy priorities for the country including strategic infrastructure plans for the coming years, there are huge investment opportunities in Somalia ranging from exploitation of its oil, gas and minerals, reconstruction of the infrastructure, revitalising and growing its fishing, livestock and agricultural sectors to manufacturing and small-scale industries.

Somalia could benefit from Chinese FDI in infrastructure projects such as the rehabilitation and expansion of airports, ports and roads. Nevertheless it must learn from the successes and failures of China's FDI in the neighbouring East African countries and others around globe, particularly the need to establish formal, transparent, mutually beneficial trade and economic cooperation agreements with China, taking into account the impact of the investment in the local economy, environment, job creation and labour conditions, and technology development.

## 4. THE SOCIO-POLITICAL RISKS OF AND TO CHINA'S FDI

China's ambitious FDI carry social, political and economic risks in relation to exploitation of natural resources and economic competition. The stability and security of Somalia are very crucial to the overall security and economic growth of the East Africa region and similarly for China's continued investment and trade in the region. The strategic importance of Somalia lies in its geographical, ethnic, social, political and economic ties with its neighbouring countries. Ethnic Somali people— who share history and identity, cultural, religious and socio-political sensitivities - reside across national boundaries in four countries in East Africa: Federal Republic of Somalia, Republic of Djibouti, the Somali Region in Ethiopia and the Somali counties in North East Kenya.

Analysts warn of possible political and security risks in the region as a result of:

- China's investment in disputed territories and jurisdictions which can contribute to tension and violent confrontation between opposing sides.
- The Chinese control and management of some infrastructure and manufacturing projects in the region can feed into the sense of suspicion about Chinese exploitation and can result a backlash

against Chinese investors.

- While investment and economic development promote and sustain peace and security, there is a risk that the recurring communal tensions between Oromo and Somali communities in Ethiopia to turn into long term violent conflict and expose China's FDI in these areas to greater risks.
- China's operations in Ethiopia, specifically in the Somali Region of Ethiopia, could be affected by tensions between Somalia and Ethiopia or events along the non-demarcated boundary of Ethiopia and Somalia.
- The maritime dispute between Somalia and Kenya can prolong the diplomatic tension between the two countries and could instigate feelings of enmity between the communities, endangering investment and economic development of both countries.
- Due to the complexity of Somalia's Federal system in resource and revenue sharing, Chinese agreements with either the Federal Government of Somalia or Federal Member States can instigate opposition from the other and jeopardize any Chinese aid and investment in Somalia.

## Associated Risks:

China's ambitious FDI carry social, political and economic risks in relation to exploitation of natural resources and economic competition. The stability and security of Somalia are very crucial to the overall security and economic growth of the East Africa region and similarly for China's continued investment and trade in the region.

## 5. COLLABORATION, NOT COMPETITION, IN ECONOMIC DEVELOPMENT SYSTEMS

### Other Development Partners:

The International and regional financial institutions could cooperate on the design and application of such an economic model to help developing countries attract more investment to spur economic growth. The World Bank has to play a greater role by, through its MIGA, extending political risk insurance and credit enhancement for investors and lenders in the East Africa region on par with the favorable insurance policies of Chinese insurers.

The Chinese economic model has its shortcomings of non-transparent conditionality of loans and lack of incentive for socio-political and economic reforms. However, the neoliberal economic policies of the Western financial institutions - deregulation of capital markets and privatisation, flexible labour markets, macro stability and decreased role of the State in return for financial assistance and investment – did not provide adequate solutions for the serious problems at the heart of the economic development of the world's poorest countries.

Thus, there is a need to develop global adaptable “Consensus” of economic policies to stimulate economic growth and development in Africa, one which charts a middle ground between the “prescriptive and excessive conditionality” of the international financial institutions such as

World Bank and IMF and “limited conditionality laissez-faire lending approach” of China. The model should combine economic and free market reforms, public and private participation, infrastructure development, innovation and technology, capital flow, access to affordable financing, good governance, rule of law, education and knowledge production.

The International and regional financial institutions could cooperate on the design and application of such an economic model to help developing countries attract more investment to spur economic growth. The World Bank has to play a greater role by, through its MIGA, extending political risk insurance and credit enhancement for investors and lenders in the East Africa region on par with the favourable insurance policies of Chinese insurers.

## 6. CONCLUSIONS

1. China's engagement and rapid rise of its investment and trade with East Africa can be viewed in the context of China's more assertive stance to lead international economic cooperation and carve up greater international influence in the world economic arena.
2. China's FDI has stimulated economic growth and development in some East African countries through infrastructure projects, producing positive economic and social results. Whilst China's FDI receives positive reviews, claims of adverse human, environmental, political and economic impact of Chinese investment and financing in East Africa are increasingly propagated. China's trade and investment is largely focused on exploitation of natural resources which has huge impact on the environment.
3. The region needs aid and Foreign Direct Investment to continue the ongoing social, political and economic reforms necessary for long term economic growth and development, however, it is fair to conclude that China's lending policies could run the risk of deepening the debt crisis in the region.
4. The increasing trade, economic and diplomatic ties between China and East Africa region, the long-term impact of Chinese aid and loans on the economic growth and development, security, social and cultural values of the people in the region call for collaborative in depth region-wide qualitative and quantitative studies.

### Need for Aid:

China's FDI has stimulated economic growth and development in some East African countries through infrastructure projects, producing positive economic and social results.

**Effective Utilization of FDI:**

The East Africa countries must utilize China FDI and loans in cost effective, sustainable development programmes and processes, considering the length and rate of repayments and return of investment.

## 7. RECOMMENDATIONS

1. The East Africa region should improve its security, political and governance conditions in order to attract more investment to improve the livelihood of its people. The countries need to work together towards closer regional economic integration.
2. The East Africa countries must utilize China FDI and loans in cost effective, sustainable development programmes and processes, considering the length and rate of repayments and return of investment.
3. The East Africa countries should develop their technical and scientific expertise to conduct credible and robust feasibility studies, social, economic and environmental impact assessments and cost – benefit analysis on infrastructure and development projects.
4. The East Africa countries must reform and liberalise their markets in order to pave the way for increased trade and investment. Ethiopia, the most populous nation in the bloc, must open up its market to private companies and competition.
5. The East Africa countries must balance the protection of national interests with the duties of good governance and the constitutional rights of citizens. They must conduct foreign trade and investment in a transparent and accountable manner and allow civil society participation in the legitimate debates about FDI and its social, political and environmental effects.
6. China must exercise responsible lending practices and provide not only financial assistance but be prepared to share knowledge and technology with East Africa countries.
7. Chinese investors need to enter joint venture and business partnerships with local entrepreneurs and manufacturers in order to boost the local economy, job creation and share the profits, knowledge and technology with the local communities.



## REFERENCES

### About SIDRA

SIDRA is a registered independent Research and Policy Analysis Think Tank based in Garowe, Puntland, Somalia.

### Our Vision

A Somalia in which social justice prevails and inclusive economic growth benefits all and improves the well being of all people.

### Our Mission

A center of development and research that generates relevant and original knowledge for dynamic policy environment support, institutional capacity development and alliance.

### Contacts



[www.sidrainstitute.org](http://www.sidrainstitute.org)



[info@sidrainstitute.org](mailto:info@sidrainstitute.org)



SIDRAInstitute



The Somali Institute for Development Research and Analysis SIDRA



SIDRAInstitute

1. Gao Jinyuan. China and Africa: The Development of Relations over Many Centuries; African Affairs; Vol. 83; No. 331 (Apr., 1984), pp. 241-250
2. Dreyer, Edward L. Zheng He: China and the Oceans in the Early Ming, 1405–1433; New York; Pearson Longman; 2007
3. Somalia to Trade With China; The New York Times Archives; P.10; June 1963
4. Yiping Huang. Understanding China's Belt & Road Initiative: Motivation, framework and assessment; China Economic Review; 40 (2016); 314–321
5. Africa Development Bank East Africa Outlook 2019, <https://www.afdb.org/en/knowledge/publications/african-economic-outlook/> accessed on 12 May 2019
6. Alvin Cheng-Hin Lim. Africa and China's 21st Century Maritime Silk Road; The Asia-Pacific Journal; Japan Focus; Volume 13; Issue 11; Number 3; Mar 16, 2015
7. Sebastian Horn, Carmen Reinhart and Christoph Trebesch. China's Overseas Lending, KIEL Working Paper No. 2132, June 2019
8. Africa's growing debt crisis: Who is the debt owed to? Jubilee Debt Campaign. October 2018. [https://jubileedebt.org.uk/wp/wp-content/uploads/2018/09/Briefing\\_09.18.pdf](https://jubileedebt.org.uk/wp/wp-content/uploads/2018/09/Briefing_09.18.pdf) accessed on 10 May 2019
9. China scales back investment in Ethiopia. Financial Times; <https://www.ft.com/content/06b69c2e-63e9-11e8-90c2-9563a0613e56> accessed on 22 May 2019
10. Ivar Kolstad & Arne Wiig. Better the Devil You Know? Chinese Foreign Direct Investment in Africa; Journal of African Business, 12:1; 31-50; 30 March 2011
11. Tull, D. M. (2006). China's engagement in Africa: Scope, significance and consequences. Journal of Modern African Studies, 44(3), 459–479
12. Questions raised over Chinese deal to fish in Somali waters, China Dialogue Ocean, March 2019, available at <https://chinadialogueocean.net/7022-china-somalia-fishing-deal/>