Horn Economic and Social Policy Institute
P.O. Box 2692 code 1250, Addis Ababa, Ethiopia. Tel: 2511 5 153262/65. Fax.2511 5 15 07 63;
Email: contacthespi@hespi.org; Website: www.hespi.org

Cooperation between China and the Horn of Africa: in the context of FOCAC and Belt & Road Initiative

1. Introduction

Over the past two decades or so, China has emerged as a *credible* partner of Africa as a source of investment and finance, technology and entrepreneurship, as well as trade and access to each other's markets, and capacity building support. The full extent of the opportunities, limitations and challenges of Chinese investment and financing, and its role and *Impact on* economic growth and inclusive development in the Horn of Africa (HoA) requires considerable assessment, review and study.

A recent study by McKinsey concluded that "In a matter of two decades, China has become Africa's biggest economic partner. Across trade, investment, infrastructure financing, and aid, there is no other country with such depth and breadth of engagement in Africa. The Chinese firms of all sizes and sectors—are bringing capital investment, management know-how, and entrepreneurial energy to every corner of the continent—and in so doing, they are helping to accelerate the progress of Africa's economies."

The focus of my presentation today is to discuss the economic, trade and finance cooperation between China and Africa over the past two decades and since the Forum on China-Africa Cooperation (FOCAC) was established, as well as the more recent contributions of the Belt and Road Initiatives in Africa. The multifaceted development cooperation has boosted trade and investment between the partners, and thus trade between china and Africa increased to $208 billion in 2019, and total Chinese FDI in Africa reached $49 billion during the same year, and more than $200 billion has been generated in financial resources for development projects as of end 2019.

Over the two decades since FOCAC, the massive economic and financial cooperation has generated large investments in economic infrastructure, in the form of the constructions of roads, railways, ports and power plants –to name but a few--that have made considerable difference in the economic and social development of many countries in Africa. The post FOCAC collaboration between the partners has also impacted well on the social developments of many countries, especially in the health and education sectors.

The broad nature of FOCAC as a platform for consultation and multilateral cooperation ranges from peace building and socio-economic relations. In this context, my remarks will focus on the role of economic and financial cooperation between China and the 8 countries of the HoA; and members of IGAD Regional Economic Community[1] ; one of the sub regions recognized by the AU. It will explicitly take into account the benefits and achievements realized, and the challenges that have been faced in the China and HoA sub region implementation of the concrete measures and mandates under the Forum and the wider multilateral relationship.

The focus on the China- HoA relations is particularly instructive in many aspects including the Following:

- The sub region comprises 8 countries, some of which like Kenya and Somalia had peaceful contacts with China many centuries , ago as described in Prof. Li Xinfeng's excellent book: "China in Africa - in Zheng He' footsteps".

- The sub region also has a number of countries, notably Djibouti, Ethiopia, Kenya and Uganda that registered high economic growth rates and broad good economic performance for nearly 2 decades; that have been the key destinations of access to substantial investments and financial flows from China.

- The sub region also includes several fragile states that have experienced economic fragility, stagnation and insecurity over many years, including Somalia and the South Sudan.

- All 8 countries of the sub-region are signatories of the BRE access articles and could benefit from such association.

[1] The HoA countries comprise the following 8 countries: Djibouti, Eritrea, Ethiopia, Kenya, Somalia, South Sudan, Sudan and Uganda.

2. China's Foreign Direct Investment in the HoA

China's expanding investment in Africa has been supported by the Forum from its inception through promoting economic infrastructure development, encouraging Chinese enterprises to invest in Africa, and facilitating the development of SMEs in Africa. The inflows of Foreign Direct Investment (FDI) to the HoA (both government and private sector) facilitated and promoted under the Forum and the support of Chinese finance and trade facilitation has enhanced the economic growth and inclusive development potential.

China's emergence as world economy power and its development and foreign relations approach is generally perceived positively in many African countries. Most observers emphasize China's diplomacy of non-interference, mutual respect and friendship with Africa together with its increased trade and investment as a sign that "China's presence in Africa should be seen as that of a partner in economic development".

In particular, the cases of more economically successful countries, in attracting large investments at concessional finance and favorable terms & conditions, encouraged much needed infrastructure other high priority productive activities that have supported these countries' economic transformation. The HoA good performers in particular were attractive to Chinese investments because of their economic growth potential, growing consumer markets, cheap labor costs and abundance of natural resources. The four countries termed good performers have received large inflows of Chinese investments.

Djibouti has been a major recipient of Chinese investment and projects financing, including the Doraleh Container terminal, the Doraleh multi-purpose port, the international free zone industrial parks operation, and rail and road projects linking the country with Ethiopia.

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

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

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

China's investments in Djibouti, Ethiopia, Kenya and the greater HoA are part of its Belt and Road Initiative (BRI) that forms part of the country's long term vision for economic strategies to safeguard and link global trade in the Asian, African and Western European markets.

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

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

Undoubtedly, Chinese investments and external financing in the well-performing countries of the HoA have been indispensable part of their economies high and sustained economic growth achieved in the past 2 decades. Such investments have contributed to providing world class infrastructural development, injected much needed capital, introduced new technologies, modern management know- how, and enhanced demonstration effects in the management of these economies.

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

The broad commentary of the policy makers in the region and few academic studies reviewed in this assessment demonstrate that the good performing countries in the HoA substantially benefited from the Chinese investments. The bulk of the Chinese firms direct investments in the industrial sector of the HoA are properly aligned with the region's interest and commitment in industrialization and economic diversification.

3. China's Investment Finance in the HoA countries

China has already become a big source of finance of Africa's development endeavors. In September 2018, at the 7th Forum on China–Africa Cooperation (FOCAC), US$60 billion was pledged in financing for Africa[2]. China has disproportionately high funding in the HoA region compared to any other sub-region in Africa. With a 25% share in total finance for Africa in 2000-17 disbursed to this sub region. The HoA countries receive asymmetrically higher Chinese funding than the rest of the African continent, with the principal sources being the Exim Bank and the Development Bank of China (Table 1).

Investment Finance in the HoA countries covered many sectors but was especially in the core areas of economic infrastructure projects, which would otherwise have been too costly for these developing countries capacity to grow their internal and cross-border economic

[2] $15 billion in grants, interest-free loans, and concessional loans; $20 billion in credit lines; a $10 billion special fund for development finance; a $5 billion fund for financing imports from Africa; and encouragement to Chinese companies to invest at least $10 billion over the next three years.

connectivity. Other significant investments were allocated to projects in power generation and distribution, building economic zones and industrial parks that promoted opportunities for jobs, economic growth and inclusive development.

Table 1 Chinese Loans to the Horn Countries and Africa in millions of USD (for the year 2000-17)

	millions USD	% Share from the horn
Djibouti	2,083	5.8
Eritrea	504	1.4
Ethiopia	13,739	38.4
Kenya	9,803	27.4
Somalia	0	0.0
South Sudan	182	0.5
Sudan	6,492	18.1
Uganda	2,968	8.3
Horn of Africa	35,770	-
Africa	143,349	-
Horn %Share from Africa	25 %	

Source: Johns Hopkins SAIS China-Africa Research Initiative, 2017

In terms of direct involvement in direct financing for investment activities, China is currently the leading bilateral partner for the HoA countries. The key HoA recipients of substantial loans and credits from China since the establishment of FOCAC coincides with the countries that attracted large investment projects in the sub region were Ethiopia, Kenya, Sudan, Uganda and Djibouti in that order.

In Ethiopia, Chinese financing covered ambitious infrastructure projects such as Ethio-Djibouti Railway, the Addis Ababa transit railway and ring road, a number of inter-city road projects, and industrial parks. , Ethiopia also benefited from Chinese funding for many Industrial parks, and signed a $1.8 billion investment agreement for electric power transmission and distribution lines in Ethiopia. The project will power up 16 industrial parks, the Addis-Djibouti railway, and some cities in the country. China's loans to Ethiopia reached $13.7 billion, through 2017 excluding loans service s repayments (according Johns Hopkins SAIS China-Africa Research Initiative).

Kenya received the second largest financing from Chinese institutions amounting to almost

US$ 10 billion, during the seventeen years ended 2017. The China's Exim Bank funding of the Nairobi-Mombasa Standard Gauge Railway (SGR), at a cost of US$4 billion, is considered the biggest investment in Kenya since its independence. Funding for additional Chinese constructed projects include $1.5 billion for investment in a dam; and $523 million in roads construction, and $255 million in a power and communication projects. Overall the country has sourced a total debt of ---- to finance Chinese build projects in the country through end 2019.

Ethiopia and Kenya are expected to have benefited from startup resources to initiate studies and technical works for additional huge Infrastructure Projects including East African Railways Master Plan and Lamu Port-South Sudan- Ethiopia Transport (LAPSSET) Corridor that links Kenya, South Sudan, and Ethiopia. Once the feasibility studies of the project are concluded and once adequate financing is assured this project will link major ports envisioned for Kenya to South Sudan and Southern Ethiopia; including the current china supported investments in South Sudan's oil; gold mining, and infrastructure.

Table 2 Chinese Loans to the Horn by Sector, in millions of US$ (for 2000-2017)

Sectors	Djibouti	Eritrea	Ethiopia	Kenya	South Sudan	Sudan	Uganda
Transport	1,557	-	4,373	5,555	158	2,513	761
Power	-	100	2,548	597	24	2,887	1,928
Communicatio	18	21	3,162	74	-	10	112
Industry	-	48	2,020	-	-	180	-
Water	322	-	634	-	-	346	-
Mining	-	60	-	-	-	-	-
Others	186	275	5,375	9,132	158	3,069	928
Total	**2,083**	**504**	**13,739**	**9,803**	**182**	**6,492**	**2,968**

Source: Johns Hopkins SAIS China-Africa Research Initiative, 2017

Note: CARI loan data represents amounts borrowed since 2000. These totals should be reported as amounts borrowed and should not be reported as current debt figures since many countries have been servicing their debts promptly and have made substantial payments on these loans=

4. Extending the Achievements under FOCAC and BRI

As noted the China Africa relationship under the FOCAC and BRI has expanded and deepened the cooperation in investments and financial access among the partners. The achievements in this area are of course intended to promote broad based economic growth and to provide the basic infrastructure to drive productive employment and sustained development. But this achievements tell only part of the story, as the China-Africa cooperation extends to other key sectors, particularly as declared at 2018 FOCAC Beijing Summit to build a stronger community with a shared future.

It is also evident that the breadth of the cooperation extends beyond focus on economic issues, as demonstrated by the efforts to provide support and strengthen health and educational institutional and governance in African countries. More specifically, there is much to commend the Chinese authorities' efforts to extend support to African countries under the difficult circumstances of the Covid-19 pandemic. The global health and economic impacts of this pandemic is having huge economic and social challenges on African countries, and foremost for the fragile economies in the HoA and elsewhere that are ill prepared to cope.

China's efforts to support Africa countries in surmounting these challenges and achieving post-pandemic recovery is vital to ensuring that the poverty reduction achieved over recent decades is not permanently reversed. Nevertheless, there are objective and fact-based concerns on deficiencies in the recent primary focus on trade, investment and finance in the current China and HoA countries relationship (and in other African sub regions) that merit consideration and assessment; so as to increase and expand the core priorities fields the successes achieved in the economic and finance cooperation in the last 20 years. These core areas of vital importance for the transformation of Africa - China urgent collaboration include, *inter alia:*

- Poverty reduction particularly in fragile economies through learning from China's successes in recent decades.

- Expanding efforts to develop Africa's industrialization through accelerated technological transfers applied on regional and continental basis

- Avoiding the risks of accumulating unsustainable external debts,

- Jointly addressing the impacts of adverse climate change that have existential threat in the HoA countries, and learning from Chinas applications to deal with such.

Modeling China's success in poverty reduction.

The concerns among academicians and some African policy makers are that the investment and financial resources from China while a key source of some African countries growth and transformation, could have unintended consequences of further aggravating the income inequalities within the continent and even within countries. First the top African recipients of Chinese finance and investments are relatively the more developed countries and /or those that have proven natural resources, such as minerals or hydrocarbons in abundance. Second, within individual countries, the projects that benefit from the Chinese financial and investment access are centered in few urban centers within the middle income African countries.

As a result, those critics expressing this concern claim that the income disparities within the continent would be further widened; and are contrary to the "Development Model of China" which targeted and achieved phenomenal poverty reduction in the country in a few decades. According to this view the most desired achievement of China's transformation is the success achieved in getting 700 million of its population, Urban and rural alike, out of poverty in a few decades; and Africa most aspires to such transformation in order to reduce abject poverty.

The challenges faced in the HoA, and other African sub regions, is that many countries face acute challenges of instability, insecurity, and poor governance that lead to limited or no access to the direct investment and financial flows achieved in the cooperation under the Forum and BRI. The principal fragile economies in the HoA include Eritrea, Somalia, and South Sudan, largely on account of prolonged economic instability and often associated with insecurity attributed to inter-state or intra state conflicts. There has been some investments in the oil and gas sector in the South Sudan by Chinese firms, but interest in other economic sectors in the fragile countries has been lacking.

A case in point is the long standing relationship of China with Somalia. Despite its diplomatic presence in Somalia since 1960, and evidence of Chinese aid to Somalia in many essential infrastructure projects in 1970-90, Somalia observers posit that no significant contribution was made to state recovery and reconstruction efforts in Somalia in the 2 plus decades of state fragility and ineffective state institutions. The evidence of fragility and ineffective institutional governance in Somalia clearly is a contributing factor to low engagement by China, but mutual benefits and joint cooperation could be explored at an early stage of recovery, as with some other bilateral engagements. In the event, different modalities of engagement to address the poor communities of the continent could well be considered to address, under the partnership, the more vulnerable communities and countries.

Technology transfers ought to be strengthened.

Policy makers and academics have argued that successes of considerable home grown technological progress in China in the last 3-4 decades will permit the well performing HoA countries to tap into this know-how and associated technology in a quick manner. The over whelming evidence however is that most of the skilled labor and advanced equipment that built the base of China's investments in Africa has remained in china and has not contributed to considerable transfer to HoA nations. A case in point is that most of the large investments in the railways industry in the HoA countries has not led to initiation of a heavy equipment manufacturing base that is essential for the sub region to develop and eventually meet its important transport requirements locally.

It needs to be underlined that host countries will not be able to capture the technological transfer benefits associated with foreign direct investment until they achieve a certain threshold in terms of skills attainment, local technological capabilities, and viable industrial development, which should all be accelerated. Accordingly, emphasis could be laid on the basis of building a viable and competitive manufacturing base in accordance with the advantages of targeted sub regions, and consistent with the African Free trade agreement under implementation.

The risks of un-sustainable debt accumulation to be avoided

Some HoA countries have accumulated high levels of foreign public debts attributable partially to Chinese loans, raising the question of how such loans may ultimately be repaid, at what cost, and what sacrifices the governments' may have to make to repay these loans. Some observers consider the accumulation of such large debts as unwise and unsustainable on the part of the HoA countries and African governments at large.

It is the responsibility of borrowing governments to ensure that the terms and conditions of the loans and credits negotiated are affordable and are used for productive investments. Moreover, the acquired foreign financing ought to generate additional productive capacity, add to foreign exchange earnings and additional value to meet debt service payments. Both the lending and borrowing countries should maintain caution, and ensure debt obligations would not lead to default and debt crisis--certainly they would both share the blame if projects considered "vanity" expenditures lead a country to quick and early debt distress. Responsible policy makers in the HoA countries (and elsewhere) should be wary and vigilant that access to funding and its terms and conditions should be based on capacity of a country to maintain debt sustainability, in the medium and long run.

The experience to date in the Horn of Africa, is that China has given borrowers more flexibility in their spending decisions and provides more accessible financing from Chinese Banks. For instance, negotiations are underway with China to secure grace period, debt relief as well as restructuring including rescheduling. China has restructured a loan size of $2.5 billion for the Addis Ababa-Djibouti railway. According to Global Construction Review (2018), the $4 billion loan maturity, which was initially ten years term, is extended to 30 years. The Export-Import Bank of China alone financed 70 percent of the project on non-concessional rates. The Ethiopia authorities reported in early 2019 that restructuring of over 60 percent of the Government's overall commercial loans to concessional terms (including the Chinese loan) was achieved.

Djibouti has also felt the debt burden and hence has sought debt rescheduling. For instance, over two-thirds of Djibouti's external public and publicly guaranteed (PPG) debt as of 2018 is owed to the Chinese Exim Bank, for which authorities reached an understanding with the Bank to restructure the loan.

Kenya expressed similar concerns about its debt structure, and the authorities are looking for grants or more affordable financing from China for future projects. Kenya requested China to provide $3.8 billion as a grant (as opposed to a loan) for phase three of the Mombasa (Kenya) -- Uganda railway. China deferred the loan until the request is fully backed by economic viability.

The existential threat of adverse climate change to be addressed

Many African countries including the Sahel sub region and some in the HoA are suffering from perennial drought and chronic food insecurity. In the Horn of Africa region, the prevalence of undernourishment is more pronounced than anywhere else in the world; hunger in these countries is one in every three persons compared to the global figure of one in every nine. Moreover, the decline in prevalence of undernourishment registered for one and a half decade seems to have ended with hunger slowly rising since 2014, and would most likely be aggravated by the Health pandemic impact on the economies of the region.

Vulnerability to food insecurity is not only high but also becoming structural with most of the poor concentrated in the arid and semi-arid ecosystems and forced to cultivate increasingly marginal lands more intensively. Low diversification into non-farm economic activities and reliance on land resulted in unsustainable exploitation of fragile ecosystem.

Drought is one of the most pervasive climate events in the region that has significant impact across the food value chain, affecting sector growth, as well as food and non-food industries and ultimately national economies. It is critical to take a long-term perspective on how to reduce vulnerability and to increase drought-resilient human and socioeconomic development efforts among the Horn's poorest communities.

The countries of the HoA lack the institutional capacity or advanced operational systems to effectively respond to the magnitude of climate change risks and the corresponding resilience building measures. This calls for establishment of Integrated Climate-Response System to build resilience as opposed to different standalone programs.

An integrated response for resilience building will help to boost overall risk-management capacity, deliver a range of programs in accordance with country needs, and link with early warning and emergency systems. In view of China's success in building models of food security and addressing adverse climate impact on agricultural productivity, ways and means of collaborating in this critical area for human resilience should be set at a higher priority in extending the achievements under FOCAC and BRI.

5. Concluding Remarks

Over the past 20 years, FOCAC has considerably enhanced the cooperation and friendship of China and Africa, and the Belt and Road Initiative could further strengthen the relationships built over the period. In particular, substantial mutual gains have been registered in the economic and financial front as demonstrated by the current magnitudes and levels of trade, investments and financial resource inflows between China and Africa. Most notably, in many African countries the state of economic infrastructure has been transformed through cooperation with public and private entities from China.

The cooperation has also been broadened in to social areas particularly in building the educational and health institutional capacities; and to strengthen knowledge base and human resources across multiple productive sectors to assist in independent development. The cooperation particular in the preparedness for, mitigation and unfinished recovery from the global health and economic impact of the Covid-19 pandemic has strengthen Chinese and African solidarity thus far, much extended assistance to the African continent from this crisis will be important for the post recovery challenges that remain.

The deepening cooperation of the mutually beneficial China Africa relations under the FOCAC for the past twenty years has been immensely effective in the core areas of engagement; notably in the development of trade facilitation, investment promotion and access to finance. Under the Forum and the BRI, the current effective practices should be further strengthened and deepened. However, the China and Africa relations should also be broadened in several fields that have been enumerated in the presentation. The areas highlighted for expanded cooperation address current binding challenges of the HoA countries, and even more importantly *China's development model* has shown effective ways to address similar challenges in its recent history. These areas are also listed as possible fields of cooperation and collaboration among the Chinese and African think tanks and research institutions in the collective efforts to generate and disseminate knowledge.