Policy Brief

CA No.11/
July 2013

Impact of China-Africa Investment Relations: The Case of Ethiopia

By Alemayehu Geda and Atenafu G. Meskel

This study investigated the growing relation between Ethiopia and China in the last decade. It is possible for Chinese-Africa relations to be either complementary or competitive (or indeed both) and it has multifaceted features. Notwithstanding this multifaceted linkage, the study focused on one of the channels – the investment (FDI) channel. Other channels are explored depending on the degree at which they shed light on understanding the Chinese-Ethiopian investment relations, which is the subject of this study. With this broader objective this study includes:

- Identification and analysis of the key features, patterns and developments in the main channels through which the impacts in growth of China are transmitted to Ethiopia;
- Qualitative and quantitative evaluation of the nature, dimensions and magnitudes of the sector-specific and overall incidence of the impacts transmitted to Ethiopia over the period 1997 to 2007 using both micro and macro data;
- Identification and analysis of sector-specific opportunities and challenges faced by Ethiopia as a result of impacts generated through the growth of and economic relationship with China; and
- Articulation and analysis of appropriate policy responses and overall development strategies for maximizing the benefits and minimizing risks emanating from the economic relationships with China.

The first part of the study describes the general background. This is followed by a section that reviews the relevant literature and presents the theoretical framework and methodology. This is then followed by a section that attempts to provide an empirical analysis, and finally conclusions are drawn and implications are offered.
In terms of methodology, the study is based on analysis of all available secondary data on China-Ethiopia relations. In addition, a survey has been conducted to acquire key information from 32 Chinese firms, 50 domestic producers, 20 consumers of Chinese products, government offices (such as the Ministry of Foreign affairs and

Trade) and other stakeholders. Questionnaires are designed for each target group and face-to-face interview is administered.

We have attempted to look this issue through theories of FDI related to its determinant and effects. We have also attempted to see the impact of trade, aid and relations between the two countries in terms of effect on Chinese investment in Ethiopia. We found that in the last five years, the Ethiopia-Chinese relation has grown quite strongly both in terms of trade and investment. This is found to be, in particular, important in the areas of road construction, supply of manufactured goods from China, telecommunication and installation of big electric power stations by Chinese companies as well as engagement of Chinese firms in Ethiopian manufacturing sector.

The success of Chinese firms in this areas is explained by the political ties their government created with the government of Ethiopia, low initial bidding price, the self financing options (sometimes referred as 'vendor financing') that they give to the Ethiopian government owing to the support they get from the Chinese government, as well as the relatively lower level of skilled Ethiopian personnel (in terms of negotiation, technical and managerial skill). The latter is accentuated by poor institutional capability of the Ethiopian experts in various ministries who are dealing with the Chinese firms. Chinese firms' cost and technological advantages over their Ethiopian counterparts and the non-conditionality of their offer are also found to be important for the success of the Chinese investment in Ethiopia.

Given the position of Ethiopia's capital, Addis Ababa, as the unofficial capital city of Africa with major continent-wide institutions being located there, the Chinese also seem to use their investments in Addis as a showcase to other African countries. This is usually done by publicly owned firms or big firms that get support from the Chinese government. In general, this study shows that the Chinese investment in Ethiopia, particularly in the manufacturing sector, could be characterized as market seeking (and to a limited degree, resource seeking).

From the study, we note that some groups will gain from this Ethio-China engagement while others that lose. The former category includes consumers and commercial traders who bring manufactured consumer goods from China for sale in Ethiopia and entrepreneurs in establishing small scale factories who buy machineries and equipment from China. The possible losers include small-scale firms engaged in clothing and footwear sectors and their employees; and traditional suppliers and contractors in the road, electric power and telecommunication sectors, which are invariably firms from industrialized countries. Also noted is that a number of Chinese firms seem insecure and some refuse to talk with researchers as they are actually engaged in areas not related to their licences. It is imperative to improve their working environment in order to address the root cause of such problems.

This study is relevant to the Ethiopian government, and perhaps also to the government of China, as well as the various stakeholders that would be affected by this engagement between China and Ethiopia. It underscores the importance of designing optimal investment, trade and industrial policies in the world of emerging China that will bring a win-win situation for both Ethiopia and China.

The first important point is that the government of Ethiopia does not seem to have any policy or strategy about its economic engagement with China that is based on studies of this kind. Such a strategy is urgently needed. Second, we have shown that there are both positive and negative impacts of the Chinese investment in Ethiopia. This calls for an appropriate policy response and incentive schemes to benefit both countries.

Third, the study noted that managerial skill transfer as well as technology transfer is very important for Ethiopian firms but found it extremely limited. One vehicle to do that is to engage in joint venture between Chinese and Ethiopian firms. Our study shows, however, that while the Ethiopian firms would like to see that, Chinese firms are not enthusiastic about it. This calls for an appropriate incentive schemes by the government that encourages such joint ventures.

Fourth, the study also noted that the level of skill and expert difference between Ethiopia and Chinese counterparts in negotiation and investment engagement might be working against the interest of Ethiopia in the short run and both countries in the long run. To tackle this, Ethiopia needs to upgrade the skill of its workforce, bureaucrats/experts in the long run. In the short run, however, it may need to use qualified consultants (say from its Diaspora or the private sector) with adequate knowledge to deal with Chinese negotiators in all areas of investment and new projects.

Fifth, Chinese investment in Ethiopia seems to be constrained by lack of skilled labour, foreign exchange as well as policy credibility of the Ethiopian government. These are areas that require immediate action to redress them. Finally, it is hoped that this study will provide a snap shot picture of Ethiopia's position in its engagement with China investment and the implication of this for the future of the two countries. It is also anticipated that academic and research institutions, professional associations, as well as the private sector, such as chambers of commerce, may also benefit from this study and build on our first effort to come up with appropriate, wide and comprehensive engagement strategy with China that will be based on rigorous study and benefit the two countries. That strategy needs to see China as a complement, not a replacement, of traditional trade and investment partners.