Chinese Investment in Ethiopia: Contribution, Challenges, Opportunities and Policy Recommendations

Gebrehiwot, Berihu Assefa and Gebreeyesus, Mulu and Weldesilassie, Alebel Bayrau

Policy Studies Institute

5 March 2020

PSI Research Report 34

Chinese Investment in Ethiopia:

Contribution, Challenges, Opportunities and Policy Recommendations

Berihu Assefa
Mulu Gebreeyesus
Alebel Bayrau

Policy Studies Institute (PSI)
Addis Ababa, Ethiopia

January 2020

THE POLICY STUDIES INSTITUTE RESEARCH REPORTS

About PSI

PSI is a semi-autonomous development research institute. PSI's primary mission is to conduct quality research on the development of the Ethiopian economy and disseminate the results to key stakeholders within and outside of Ethiopia. For more information, as well as other publications by PSI staff and its affiliates, go to https://psi.gov.et/

ABOUT THESE RESEARCH REPORTS

The Policy Studies Institute Research Reports contain research materials from PSI and/or its partners. They are circulated in order to stimulate discussion and critical comment. The opinions are those of the authors and do not necessarily reflect that of PSI's, their home institutions' or supporting organizations'. Comments may be forwarded directly to the author(s) respective addresses.

Report citation:

Berihu Assefa; Mulu Gebreeyesus; and Alebel Bayrau. 2020. Chinese Investment in Ethiopia: Contribution, Challenges, Opportunities and Policy Recommendations. PSI Research Report 34. Addis Ababa: Policy Studies Institute.

About the Author(s)

Berihu Assefa, Lead Research Fellow, PSI, berihuua86@gmail.com
Alebel Bayrau, Lead Research Fellow, PSI, alebel.bw@gmail.com
Mulu Gebreeyesus, Lead Research Fellow, PSI, mulu.yesus@gmail.com

Contents

1. Introduction and background

Development economists and policy makers alike have long recognized the importance of investment as a major source of long run economic growth. Investment is treated as one of the most important factors determining economic growth in nearly all growth models (Solow, 1956; Romer, 1986; Lucas, 1988). Also, empirical evidence and experiences from East Asian countries show that growth cannot be sustained without technological and industrial upgrading, to which foreign direct investment is central (WB, 2012).

Ethiopia is now in the last phase of implementing GTP-II (2015/16-2019/20), which sets ambitious targets for industry and manufacturing to grow at an average rate of 19.8% and 23.9% per annum respectively, leading to a rise in its GDP share to 23% (and manufacturing to 18.8%) by the end of the GTP2 period while that of agriculture and services decline to 36% and 41%, respectively. This industrial development vision and target hinges on attracting both domestic and FDI manufacturing firms. Following this, the Ethiopian government envisages rapid industrialization through enhancing technological capability and skills development driven by investment linkages.

Ethiopia's performance in terms of investment attraction in the recent past has been remarkable. Due to its favourable policy and labour-cost advantages, Ethiopia has already attracted large projects and brand manufacturers in labor intensive manufacturing in textile and garment, leather and leather goods production. Ethiopia is already becoming the preferred destination of FDI in the sub-Saharan Africa. In 2017, for example, only Egypt (7.4 billion USD) attracted more FDI than Ethiopia (3.6 billion USD) and half of the total FDI committed in East Africa in 2017 went to Ethiopia (UNCTAD, 2018). And according to sources from the EIC, Ethiopia accounts for 18.5% of all jobs created through FDI in Africa.

For much of the last decade or so Ethiopia has been a leading investment destination for China. Although foreign direct investment (FDI) to Ethiopia has been hampered by unrest in recent years, it remains on an upwards trajectory. FDI inflow from China to Ethiopia has increased substantially over the past decade, with more than 70% of it going into the manufacturing sector. The number of Chinese FDI projects in Ethiopia has increased from just 87 in 2005 to 1151 in 2017. However, by looking at the number of FDI projects and FDI levels (in percent of GDP) currently observed in Ethiopia, and specifically in comparison to successful FDI-led industrialized East Asian countries, it is clear that there is an opportunity to improve the promotion of incoming foreign investment from China and other countries. Maximizing the opportunities and alleviating the investment constraints will unleash Ethiopia's potential to attract Chinese businesses for sustained industrialization.

Some research evidence already exists in Ethiopia identifying the general categories of constraints affecting the performance of existing investors, including World Bank Survey on Chinese FDI in Ethiopia, and World Bank's Doing Business and Enterprise Survey reports. The 'World Bank Survey on Chinese FDI in Ethiopia' study was conducted in 2012. The main drawback of this study is that it is too old to actually depict the current constraints and opportunities for Chinese businesses in Ethiopia. The other studies are generic and not specific to Chinese businesses in Ethiopia. One would not be able to generate meaningful and specific recommendations based on these generic studies. These reasons warrant an up-to-date and specific study that documents the roles of Chinese FDI in Ethiopia's industrialization, the key constraints they face and existing opportunities that need to be tapped for further business growth for Chinese businesses and Ethiopia's industrialization.

Recognizing the immense potential for greater Chinese investment promotion and its contribution to Ethiopia's industrialization and acknowledging the gaps, we aim to conduct a rigorous research through analysis of secondary sources and qualitative survey of Chinese enterprise doing business in Ethiopia in various sectors. In this regard, the key policy questions that this study tries to answer are 'the involvement in and the contribution to Ethiopia's industrialization and the challenges and opportunities they face. Hence, the overall objective of this research will be to (i) assess the trends in Chinese enterprises involvement in Ethiopia's industrialization for the last decade, (ii) inform both the Chines government (China Chamber of Commerce) and Ethiopian government on key business barriers and market failures that are constraining Chinese business entry and growth in Ethiopia; (iii) investigate the immense untapped investment potential from China that can be attracted and opportunities that Ethiopia could offer to Chinese investors; and (iv) propose policy options on how to address the challenges and thereby maximize the opportunities to enhance Chinese investment towards Ethiopia's industrialization.

Toward this we administered a semi-structured survey that covers various aspects of the Chinese FDI climate in Ethiopia, including infrastructure, land, security, competition, finance, skills, tax issues, and untapped opportunities for Chinese firms doing business or contemplating to enter in Ethiopia. The analysis also used extensively secondary data from different sources in addition to review of existing literature.

Understanding the state of Chinese investment in Ethiopia, the fundamental challenges facing Chinese investors, and the opportunities for future engagement is of particular interest to both Chinese and Ethiopian policymakers, and Chinese businesses. This is useful for the Ethiopian government to know what policy measures it can take to improve the business environment for foreign investors in general and Chinese investors in particular so that it can expand economic growth and job creation in the country. On the other hand, the results of the study will be useful for the Chinese firms to inform them of the investment opportunities and businesses cases in Ethiopia for their future investment and growth.

The rest of this report is organized as follow. Section two presents our approach to conducting this study including the sampling techniques, data collection and analysis methods. Section three presents review of the related literature and policies focusing on China's economic policy to Africa and Ethiopia. Section four discusses the involvement of Chinese enterprises in Ethiopia by looking at the trends and distribution by sector, location and ownership structure. This section also tries to understand the trends and distribution of Chinese FDI to Ethiopia in comparison with other African countries. Section five presents the contribution of Chinese enterprises in Ethiopia in terms of capital, employment, export and technology transfer. Section six and seven discuss the key barriers (obstacles) to Chinese enterprises and untapped opportunities for Chinese enterprises respectively. And the last section concludes and presents policy recommendations.

2. Approach

We begin with stock taking and analysing of existing quantitative data and recommendations already available from various sources and studies. But those are quite limited in terms of fully answering the research questions we have raised. Our main approach has been to use qualitative semi-structured interviews with firms to collect data. This approach is useful to identify the wide variety of business environment obstacles that hinder business entry and growth in Ethiopia. The fact that we followed a semi-structured allowed us to ask questions on how and why specific processes, laws, policies and constraints are hindering smooth and efficient business operations. The qualitative semi-structured approach enabled us not only to identify the most critical barriers, but it also allowed us to identify existing and emerging opportunities for growth that existing and prospective investors can seize.

2.1. Data and sampling

In a nutshell, our approach has followed the following steps:

Step 1: Review (stock take) of existing literature and quantitative data (mainly from EIC and UNCTAD)[1] and recommendations already available from various sources and studies. We used This process focused on reviewing the main constraints affecting the entry and performance of Chinese enterprises in Ethiopia and further developing and updating the recommendations already made for policy makers to consider (particularly focusing on what the Ethiopian government can do). The review also includes policy issues and regulatory frameworks.

Step 2: Qualitative semi-structured interviews with firms who have set up business and are operating in Ethiopia. We select sample firms from selected major sectors and conduct interviews to find out, from their experience, what were the factors that led to either their success or failure in operationalizing their investment idea and in operating their business

[1] UNCTAD Bilateral FDI Statistics; China Statistical Yearbook: "Oversea Direct Investment by Countries or Regions", various years. Statistical Bulletin of China's Outward Foreign Direct Investment, various years. http://www.stats.gov.cn/english/statisticaldata/AnnualData/; and http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx

smoothly. First, we select sectors based on two main criteria. The first criterion is to select sectors where many Chinese enterprises are involved. These sectors include manufacturing, construction and infrastructure, and ICT. The second criterion is to select sectors that have great growth potential even if only limited number of Chinese enterprises is involved such as mining, agriculture, and logistics. The aim is to interview at least 3 representative firms from the above selected sectors.

Step 3: Semi-structured interviews with key informants including the Ethiopian Investment Commission, Ministry of Industry and other relevant government agencies and Chinese counterparts to verify the information mentioned by firms on the regulatory obstacles.

2.2. Data analysis method

The contribution and involvement chapters largely rely on secondary data collected from the Ethiopian Investment Commission, Ministry of Trade and Industry, and Chinese Embassy and other Chinese organizations and UNCTAD. On the other hand, the chapters on challenges and opportunities and the policy suggestion on how to alleviate the challenges and realize the opportunities will largely rely on firm and key informant interviews. While the secondary data obtained from EIC, UNCTAD and other sources is analysed using descriptive statistics including trend analysis on China's engagements as well as describing the current key features of its involvement in the country, the primary interviews are analysed using the method of thematic analysis in describing and interpreting the qualitative data we collected through firm interviews. Basically, the analysis proceeds as follows:

(i) Transcription – first, transcripts are typed, edited and labelled. This makes the analysis process much easier and consistent.
(ii) The next step is reviewing the transcripts to understand the information collected. This gives us a sense of the bigger picture before moving into the details. This stage helps the formulation of the thematic areas that have emerged from the data.
(iii) The third step is then developing thematic areas. The paper is organized based on the emerging themes from the data. The process of developing emerging thematic areas entails grouping or categorization of data of the same or related meaning.
(iv) In the final step, we undertake a deeper analysis of patterns and the thematic areas that have emerged. Emphasis to an issue has been given not only based on how

frequently it emerged but also on the energy and enthusiasm it generated during the discussions. We also investigate deviant cases and provide explanations in an attempt to draw strong and weak patterns.

3. Policy and literature review

3.1. How important is China to Africa

Africa's growth performance has improved significantly in the last two decades. Average annual GDP growth in 38 African countries was 4.9% between 2000 and 2015. There are various factors that have contributed to Africa's better economic growth, including a marked improvement in institutions and infrastructure and a decrease in conflicts and macroeconomic distortions (OECD et al., 2013; UNECA, 2013). On the other hand, over the last 15 years, China has become a major economic partner of sub-Saharan African countries. The share of Africa's exports going to China increased from around 2 percent of total exports in 1998 to a little over 25 percent of total exports in 2015. The share of Africa's imports coming from China also increased rapidly over this same period from around 4 percent in 1998 to around 26 percent in 2015. Similarly, there has been a rapid increase in Chinese FDI to Africa over the same period. While overall FDI stocks in Africa increased from around $200 billion to almost $530 billion, China's share in Africa's FDI stocks increases from less than 1 percent in 2005 to 6 percent in 2015 (Deborah et al, 2017). Additionally, Chinese aid initiatives in Africa in the form of economic or technical cooperation have also increased remarkably since 2000. Evidences based on data from China's National Bureau of Statistics (NBS) show that the turnover on economic cooperation projects in Africa reached $29 billion in 2011 compared to $1.2 billion in 2000 (Matthias Busse et al, 2014).

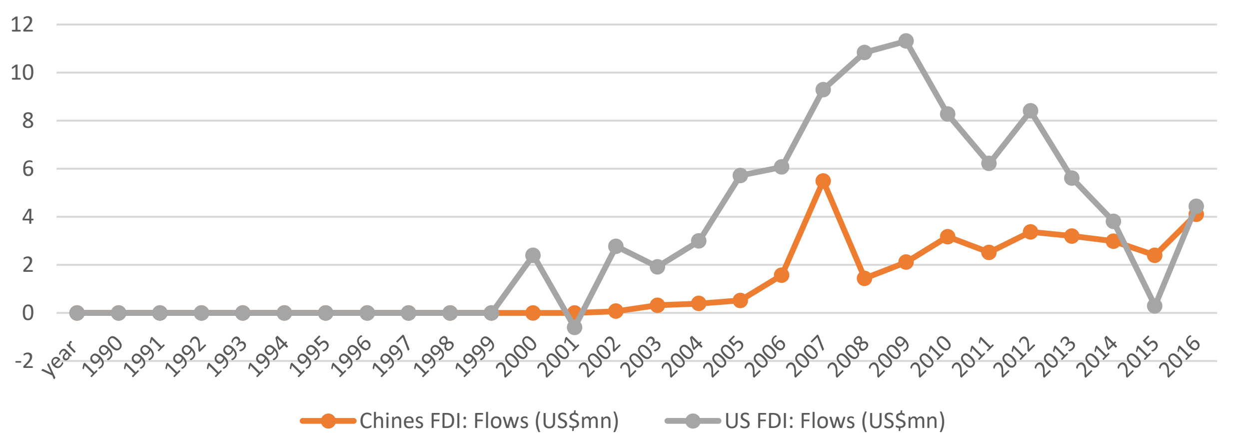
In relation to Ethiopia, the country performed well in terms of economic growth and poverty reduction between 2000 and 2015. Its economy has been growing on average at 11% per year. Poverty has also reduced substantially from 45% in 1995 to below 23% by 2015 (NPC, 2016). Similar to other African countries, China's engagement in Ethiopia has been growing substantially since 2000. The question arises as to whether China's engagement in Africa, in general, and Ethiopia, in particular, has contributed to the economic growth of African countries including Ethiopia. In this regard, anecdotal evidence revealed various arguments. On the one hand, the fact that growth has been rapid in many resource poor countries, and has continued past the collapse in commodity prices, calls into question the notion that Africa's recent performance is intimately tied to Chinese demand for its commodities (Deborah et al. 2017). In this regard, the literature tend to describe China's engagement with Africa as exploiting natural resources and local labour while undermining democracy. On the other hand, evidences also revealed that China is credited with boosting growth across the continent (Deborah et al, 2017). Based on Chinese official data, Deborah et al (2017) provided their view on Chinese investment on Africa and its implications to the continent's growth. The study indicated that China's influence in Africa is much smaller than is generally believed, though its engagement on the continent is increasing. African countries make up less than four percent of China's global trade and less than three percent of China's global FDI flows and stocks. We also show that mining and construction account for the bulk of Chinese FDI in Africa (54 percent). However, the stock of manufacturing FDI is increasing and reached 13 percent of China's FDI stocks in Africa in 2015. Overall, the study revealed that Chinese investment in Africa, while less extensive than often assumed, has the potential to generate jobs and development on the continent. With regard to the sectoral structure of FDI stocks, the study shows that the top five sectors that capture 70 – 80 percent of the Chinese FDI stock between 2013 and 2015 are mining, construction, manufacturing, finance and business service. Though the majority of Chinese FDI in Africa are still in mining and little in business service sector in this period, Chinese FDI in manufacturing is increasing.

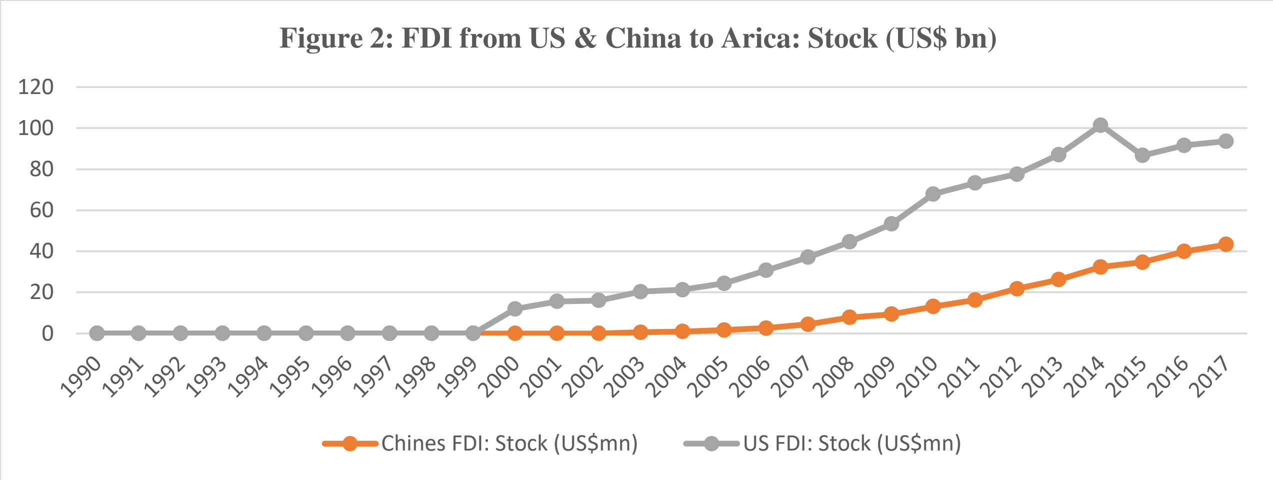
3.2. Overview of Chinese FDI in Africa

Sino-African economic relations have only surged since 2000 but the political relationship between China and Africa dates back many decades. The importance of Africa in China's foreign policy culminated in the establishment of the Forum on China-Africa Cooperation (FOCAC) in 2000. The forum holds ministerial conferences every three years and is an important platform to implement specific economic policy programs with Africa. Moreover, China's "Going-Global" policy, announced in 2001, also contributed to the rise in Sino-African economic relations. When analyzing Sino-African economic relations, three channels of economic interaction are dominant, namely trade, aid (economic cooperation) and FDI. Evidences also revealed that the Chinese government supports economic cooperation projects in Africa and often links them with FDI and trade activities. In this regard, infrastructure (railways, roads, and telecommunication) and facility construction projects such as government buildings, stadiums, etc can be mentioned (Biggeri and Sanfilippo, 2009). In addition to the fact that China provides financial aid in the form of grants, zero-interest loans, debt relief, and concessional loans as well as preferential export credits, from Chinese banks (Bräutigam, 2011), the China Africa Development Fund launched by the China Development Bank in 2007 provides equity investment capital for Chinese enterprises to invest in Africa.

With regard to Foreign Direct Investment (FDI) inflows to Africa from China, Chinese FDI to Africa is almost nil until 2000. It started an upward trend since 2000 (figure 1). As it can be seen from the figure, Chinese FDI to Africa has been shown a remarkable growth. Even if Chines FDI to Africa is relatively low compared to US FDI to Africa, the data shows that FDI from China has been growing since 2000. In terms of flows Chinese FDI to Africa overpassed that of US FDI to Africa in 2015. This is mainly due to the fact that whereas US FDI is declining since 2010, Chinese FDI has been increasing since 2000. In terms of Stock, FDI to Africa has also been increasing both from China and US since 2000 though still Chinese stock FDI is relatively low compared to that of US (Figure 2). Overall, even if average Chinese FDI flows to Africa in 2000 – 2011 accounted for only 5 percent of total FDI flows to Africa, it has been growing since 2000 and currently Chinese investment in Africa is the biggest among developing countries (UNCTAD, 2013).

Figure 1: FDI from US & China to Africa: Flow (US$bn)





Even if Chinese FDI to Africa has been growing since 2000, its distribution among the African countries varies. Evidence shows that Chinese investment is particularly an important source of capital for certain African countries. Major African host countries in terms of Chinese FDI stock are South Africa, Sudan, Nigeria and Zambia. Evidence revealed that Chinese FDI accounted for 52 percent of FDI inflows in Zimbabwe, 26 percent in Mauritius and 13 percent in both South Africa and Zambia for the period between 2000 and 2011 (Matthias Busse, et al, 2014).

Figures 3 and 4 show the trends in Chinese FDI to selected African countries and Ethiopia. Figure 3 shows that Chinese FDI in millions of USD has been growing in all Ethiopia, Ghana, Kenya, Mauritius, Nigeria, South Africa, Tanzania and Zambia between 2003 and 2017. However, the amount and rate of growth is not similar among countries. The largest Chinese FDI flows to Nigeria and South Africa in 2003. The flow was 56.4 Million USD and 53.6 MUSD, respectively. The lowest flow went to Ethiopia, which amounts to 5.76 Million USD in 2003. Total Chinese FDI increased to 7.86 Billion USD in South Africa, 2.99 Billion USD in Nigeria and to 2.2 Billion USD in Ethiopia in 2017. Figure 4 shows Ethiopia's share of Chinese total FDI to Africa for the period between 2003 and 2017. Chinese FDI stock to Ethiopia increased from 1% of total Chinese FDI stock to Africa in 2003 to 5% in 2017 whilst FDI flow increased from 1 percent in 2003 to 14 percent in 2017. A detail investigation of the data revealed that the share of Chinese FDI flow to Ethiopia reached the highest 16% in 2016, after which it declined into 4% in 2017. See figure 4.

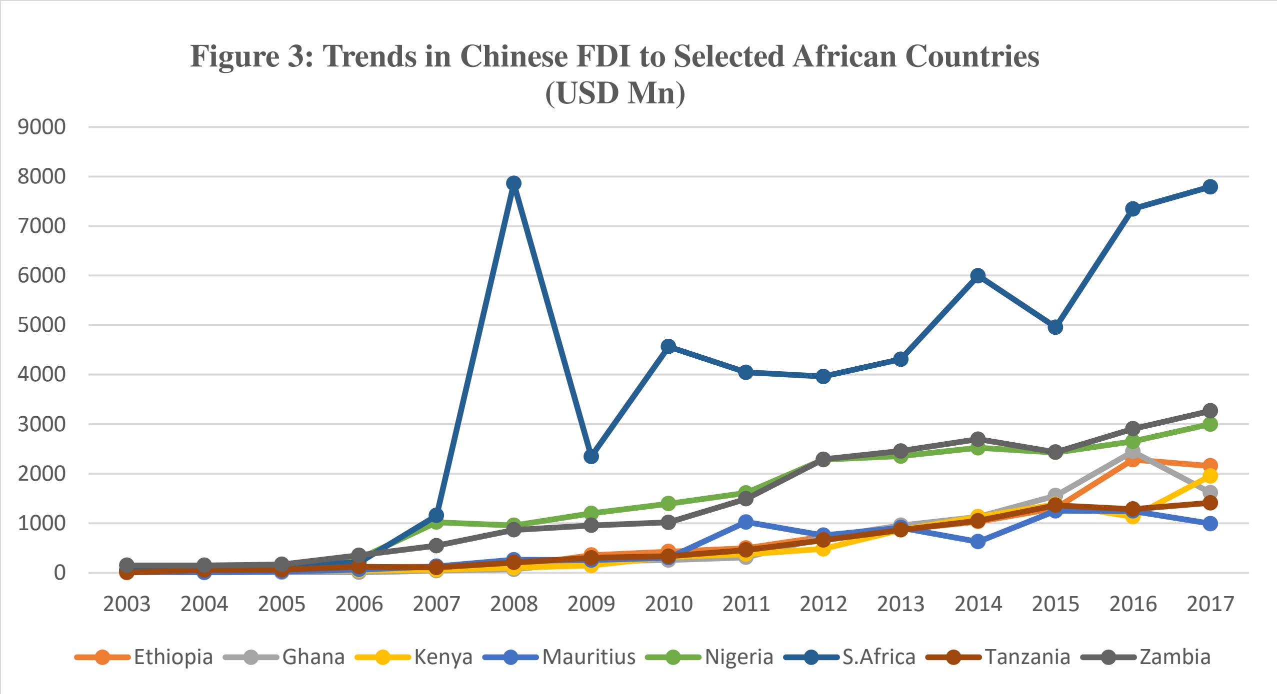


Figure 3: Trends in Chinese FDI to Selected African Countries (USD Mn)
9000
8000
7000
6000
5000
4000
3000
2000
1000
0
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
Ethiopia
Ghana
Kenya
Mauritius
Nigeria
S.Africa
Tanzania
Zambia

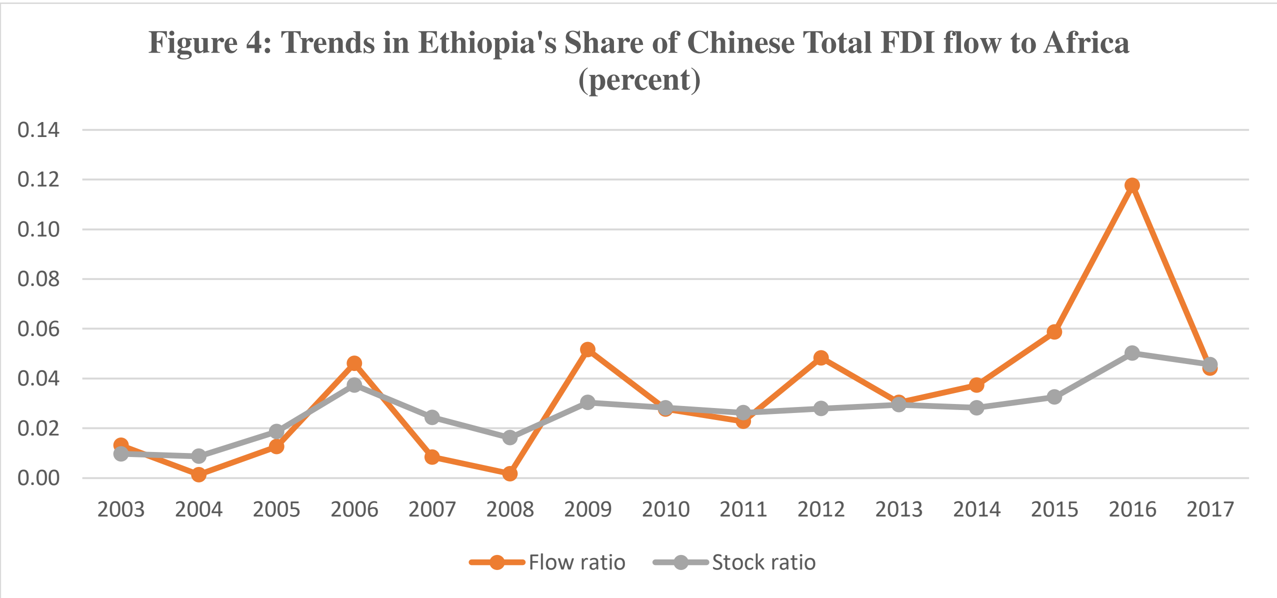


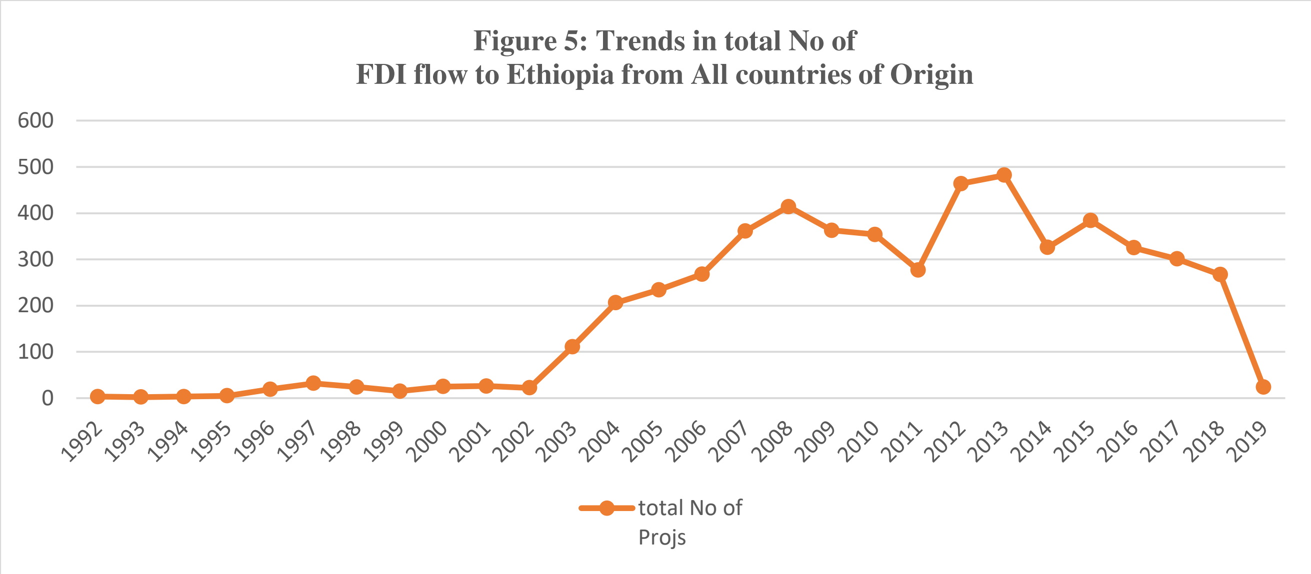
Figure 4: Trends in Ethiopia's Share of Chinese Total FDI flow to Africa (percent)
0.14
0.12
0.10
0.08
0.06
0.04
0.02
0.00
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
Flow ratio
Stock ratio

4. Analysis of the involvement of Chinese enterprises in Ethiopia's industrialization

4.1. Trends in FDI to Ethiopia

This section presents trends in FDI flow to Ethiopia from all countries including China in terms of number of enterprises, their country of origin, their investment status and contribution. The discussion in this section is mainly based on data on "List of Licensed Total Foreign Direct Investment Projects from August 22, 1992 to January 24, 2019 GC " obtained from Ethiopian Investment Commission (EIC) . Figure 5 shows the trends in total number of foreign enterprises flow into Ethiopia for the period between 1992 and 2019. The trend shows that number of FDI flows to Ethiopia has been stagnant between the period 1992 and 2002. During this period the maximum number of FDI flow was observed in 2001 when it reached 26 number of FDI from 3 numbers of FDI in 1992. It started to increase since 2002 until it reached its pick in 2013. The number of FDI from all countries in Ethiopia increased from 22 in 2002 to 111 in 2003. It became double in 2004 then reached its maximum number of 482 in 2013, from which it declined to 267 in 2018. The lowest number of FDI flow to Ethiopia is observed in 2019 when numbers of FDI reached 24, the lowest in one and half decades.

Figure 6 shows the investment status of FDI flows to Ethiopia from all countries for the period between 1992 and January 2019. Of the 414 total numbers of FDI flow to Ethiopia from all countries in 2013, 302 became operational in the same year. This makes the conversion rate from registration to operation 73 percent. The rest were either under implementation or pre – implementation stages. In terms of rate of conversion, the highest rate is observed in 2007, during which of the 361 total numbers of FDI, (290) 80% became operation, 53 were under implementation stage and the rest 18 were in their pre – implementation stages.



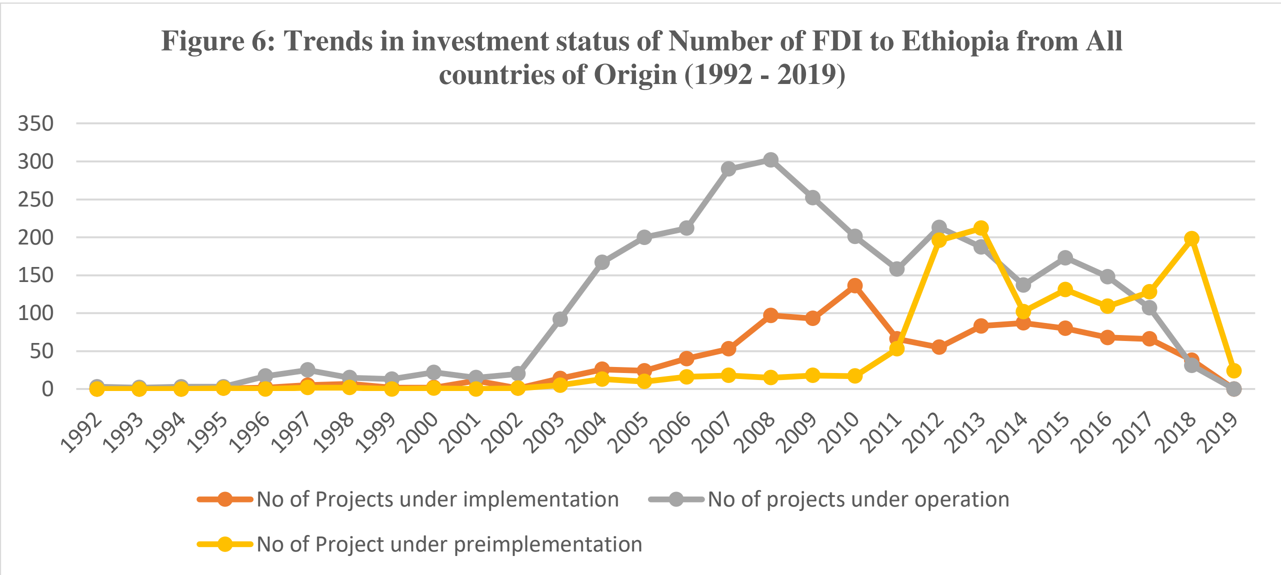
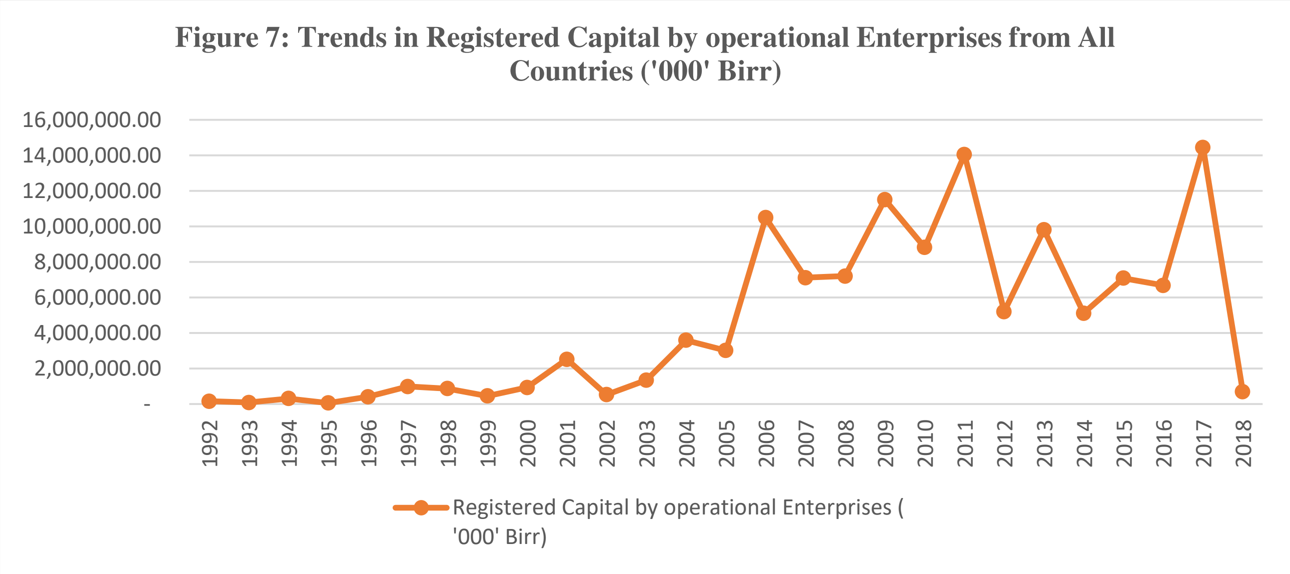
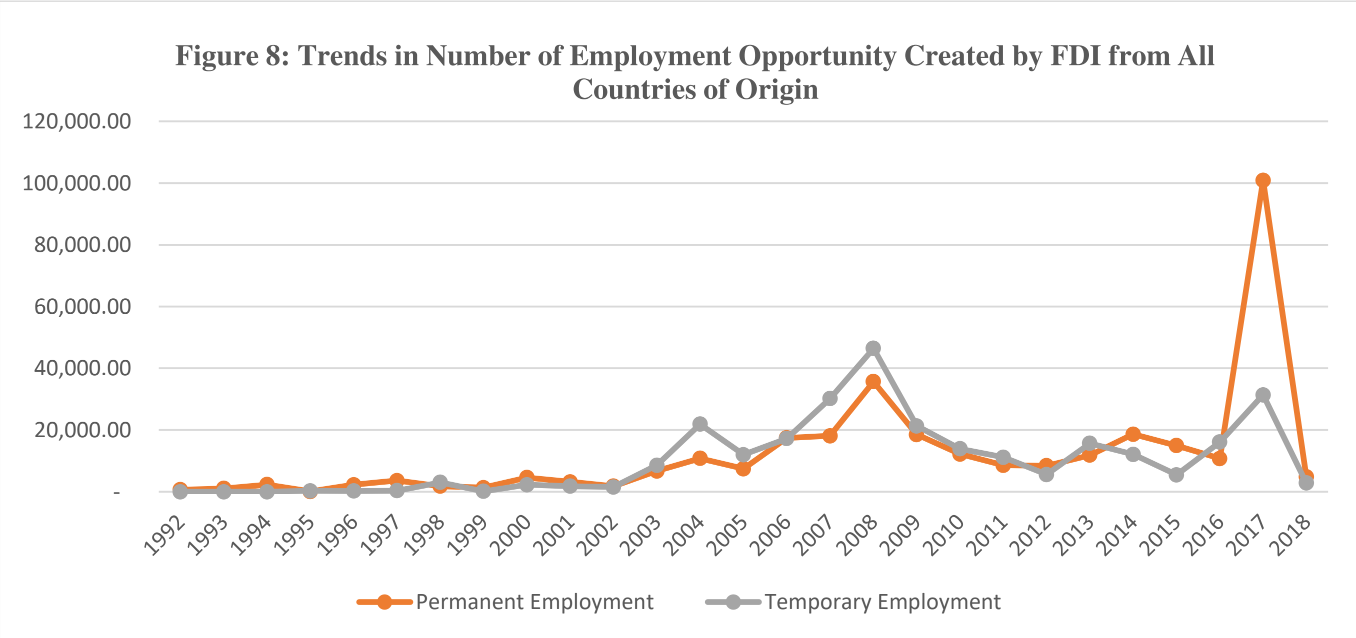


Figure 7 shows the trends in capital investment of FDI flows from all countries in Ethiopia. The trends generally shows an upward trends since 1992. However, a detail look at into the data revealed that capital investment has been increasing between 1992 and 2011. It then declined until 2016, after which it reached the highest in 2017 then decline in 2018. The same trend is observed in number of employment opportunities created (Figure 8). Number of employment increased until 2008. It increased from 693 number of permanent employment in 1992 to 32,722 in 2008. Then it declined into 10,800 numbers of permanent employment in 2016. The highest number of permanent employment is observed in 2017. During this year, total number of permanent employment reached more than 100 thousands. Overall, on average FDI created 176 permanent employment per project during the period 1992 to 2018.





Figures 9 and 10 show sources of FDI to Ethiopia by countries of origin since 1992. As it can be seen from Figure 9, the total numbers of FDI to Ethiopia registred by the Ethiopian Investment Commission is more than 5300. The major countries of origin are from Germany, United Kingdom (UK), France, Australia, the Netherlands, Saudi Arabiya, India, USA, Canada, China and others. Of these countries, more than 1350 are from Chinese FDI to Ethiopia, which accounts more than 25 percent of the total FDI to Ethiopia between the period 1992 and 2019 (Figure 10). Next to China, FDI from USA and Canada accounts 9.7 percent, followed by India FDI. Figure 11 shows the trends in FDI by country of origin for the period 1992 to 2019. Chinese FDI to ethiopia has been increasing since 1998 and reached the highest in 2018. During this period, chinese FDI to Ethiopia show downward trend between 2008 and 2014 except for the year 2013. It declined from 91 to 43 in 2011 and start to rise to 117 in 2013 then declined to 85 in 2014. A sharp decline is observed from 167 numbers of FDI in 2018 to only 15 in 2019. Similar trend has been observed for FDI from other countries of orign. For the FDI trend from all countries between the period 1992 and 2019, see figure 11.

Figure 9: Investment Flow to Ethiopia From China and Other Countries (1992 - 2019)

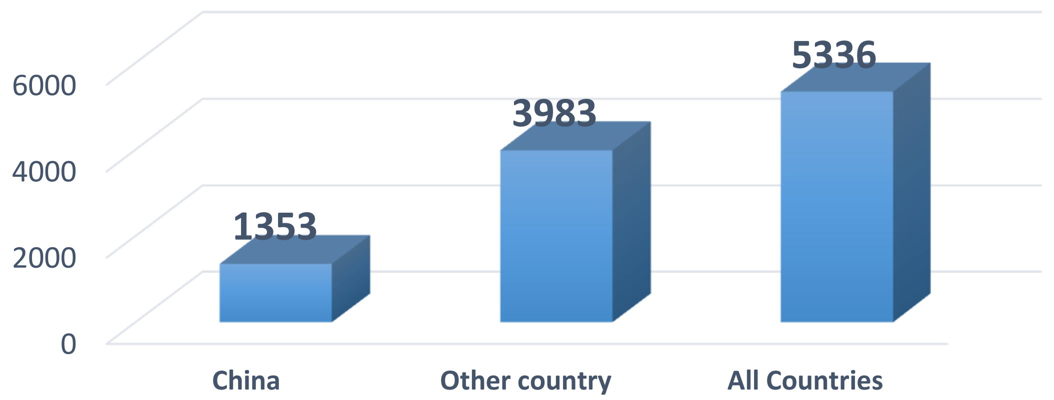
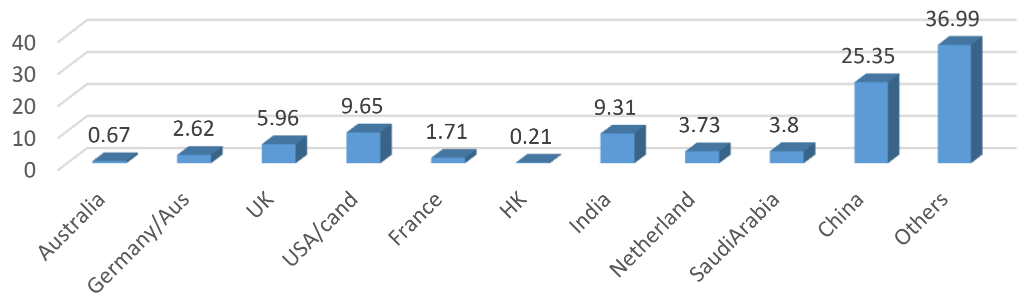
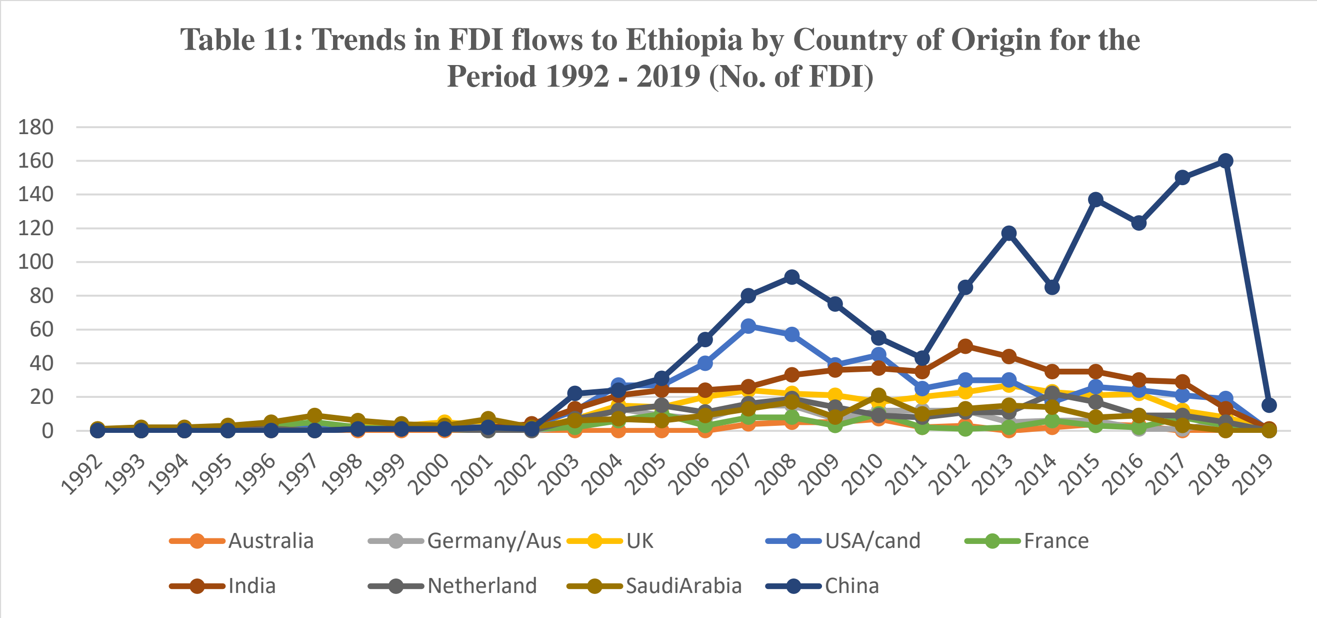


Table 10: Share of Chinese FDI from to Ethiopia compared to FDI from all countries of Origin (Percent)





4.2. Involvement of Chinese Enterprises in Ethiopia

In the previous sections, an overview of Chinese FDI to Africa and the various sources of FDI to Ethiopia including China is described. A comparison of the Chinese FDI and other countries of Origin to Ethiopia is also presented. We have seen that even if the share of Chinese FDI to Ethiopia from other African countries is small, Chinese FDI to Ethiopia accounts more than 25 percent of total FDI to Ethiopia from all other countries of origin. This section presents a detail description of the nature and contribution of Chinese FDI in Ethiopia's economy. A more detail investigation of the trends in Chinese FDI, their investment status, sector of engagements, their geographical distribution and ownership status will be presented first. This is followed by a presentation of the results from the analysis of their economic contribution.

4.2.1. Trends in investment status of Chinese Enterprises in Ethiopia

As it is shown in figure 11, Chinese FDI to Ethiopia has been increasing since 1992 though a sharp growth in Chinese investment has been observed after 2002. Growth in Chinese investment generally increased until 2018. A sharp decline was observed in 2019, during which only 15 enterprises are registered officially in Ethiopia. The investment status of Chinese enterprises in Ethiopia is shown in figure 12. Of the total 1353 numbers of Chinese

FDI to Ethiopia, 829 became operation, 207 are under implementation and the rest 317 are under pre implementation stages (Figure 12). That is, the rate of conversion of Chinese enterprises to become operation is 61 percent. At least 15% and 23% are under implementation and pre implementation stages, respectively (Figure 13). Compared to the conversion rate of FDI from other countries, Chinese investment has higher rate of conversion. Figure 13 shows the conversion rates of FDI from Chinese, other countries and all countries. It is indicated that while 61% of Chinese investment became operation, about 55% of FDI from other countries became operational. The trend in conversion of Chinese investment in Ethiopia has generally been increasing since 1992 until 2008. During this period, the majorities of Chinese investment became operation. Starting from 2010, the rate of conversion of Chinese investment show a declining trend. On the other hand, the number of Chinese enterprises under pre-implementation stage are generally rising until 2018. The number of enterprises under pre implementation stage became greater than the number under operation in 2018. See figure 14 for the trends in conversion rate of Chinese investment in Ethiopia between the period 1992 and 2019.

Figure 12: Investment Status of FDI from China & Other Countries

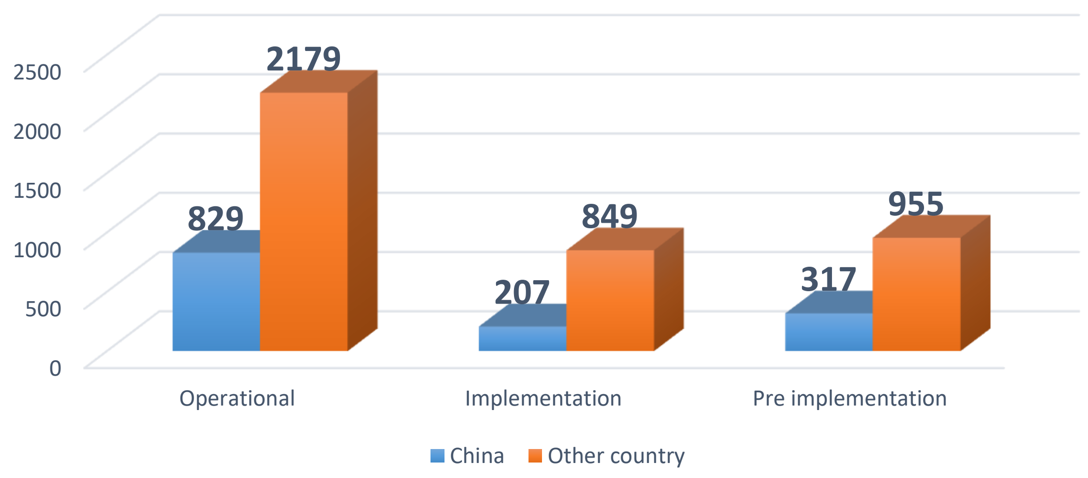


Figure 13: Operational rate of Chinese Investment compared to Other Countries' Origin

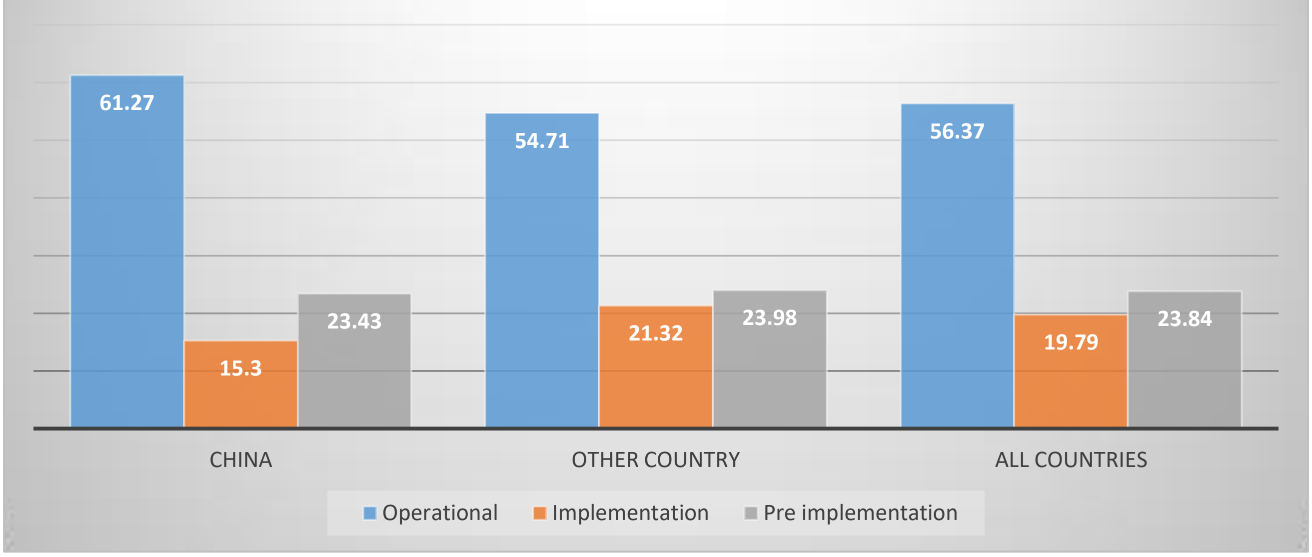
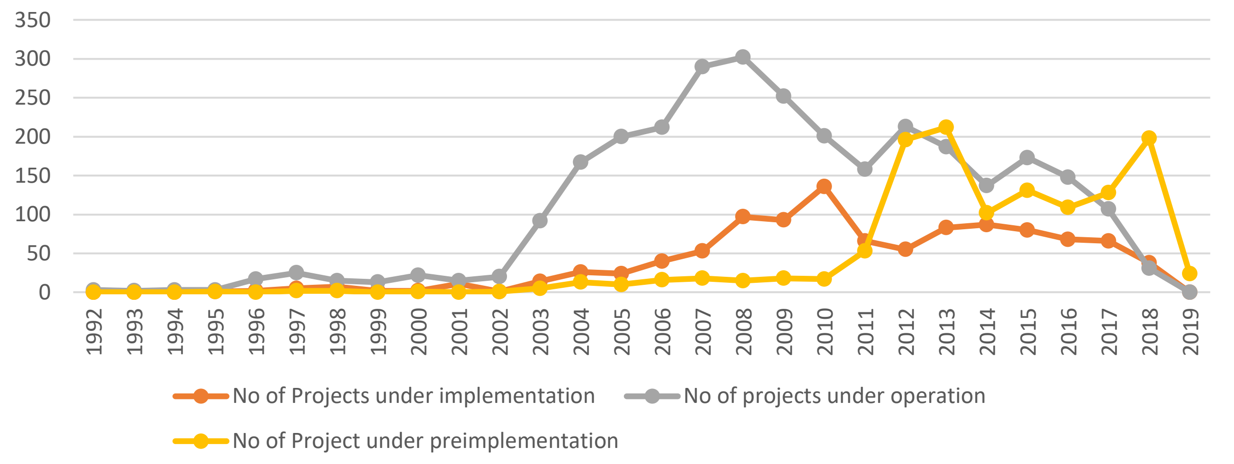


Figure 14: Trends in number of Chinese Investment in Ethiopia by Investment Status (Number per year)



4.2.2. Investment Sector

Figures 15 and 16 show the sectoral distribution of Chinese FDI in comparison with FDI from other countries of origin. Of all foreign investment in Ethiopia, 49 percent is in manufacturing sector, followed by investment in real estate and hotels (27 percent). Agriculture accounts for 11 percent of total foreign direct investment in Ethiopia. A better understanding on the sectoral distribution of FDI in Ethiopia can be obtain when we disaggregate the data between china and other countries. The vast majority of Chinese investments are engaged in manufacturing sector in Ethiopia. At least 70 percent of Chinese enterprises invest in the sector. Real estates and hotels accounts for the second share in Chinese investment. About 15 percent engaged in this sector. Construction is the third important sector that Chinese enterprises invest their capital in Ethiopia. It accounts for 12 percent of the total Chinese investment in Ethiopia. While agriculture takes about 15 percent of the share of total investment of other countries in Ethiopia, the sector takes only less than one percent the total Chinese investment in Ethiopia.

Figure 15: Distribution of FDI from China and Other Countries by investment sector (1992 - 2019)

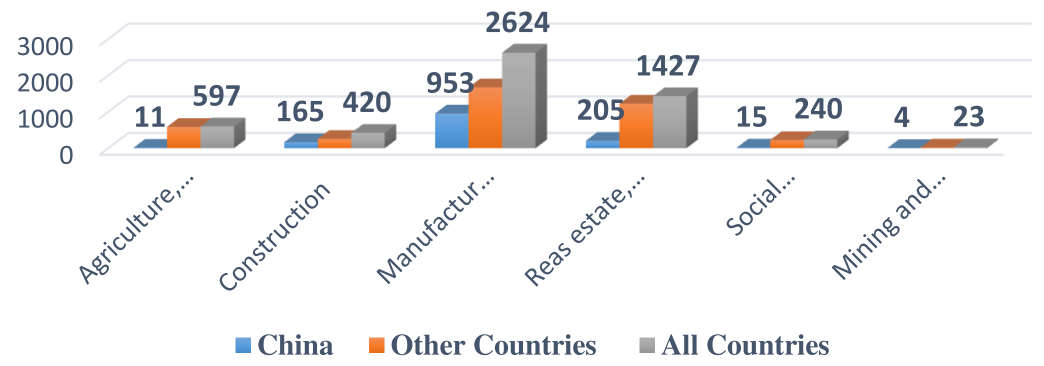
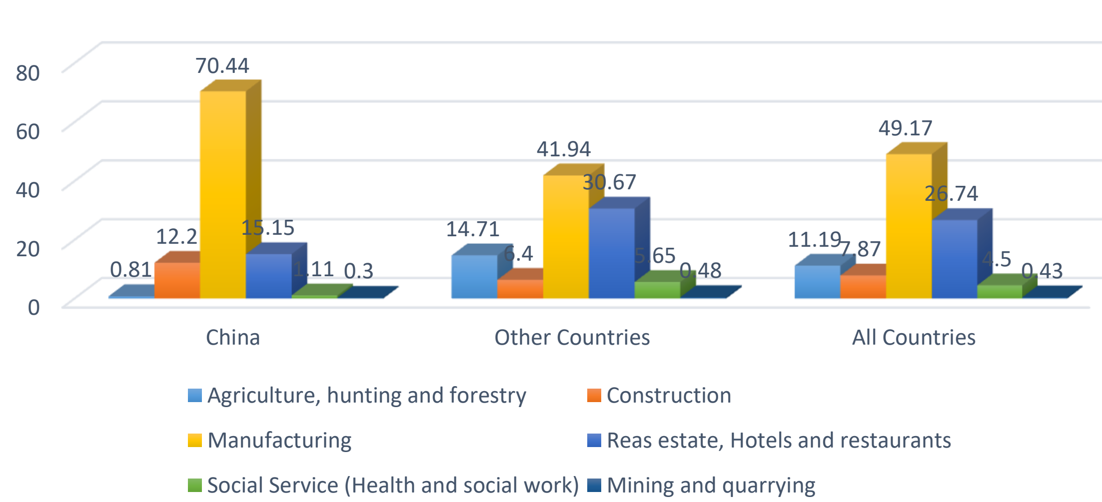


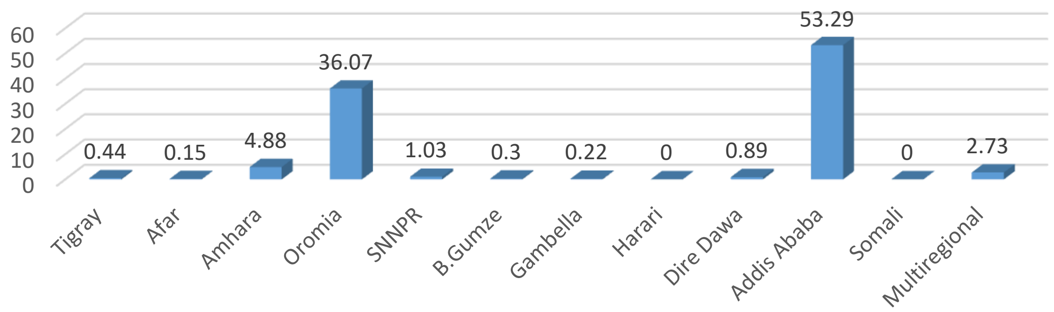
Figure 16: Distribution of FDI by Country of Origin by investment sector (percent)



4.2.3. Geographical Distribution

Looking into the geographical distribution of Chinese investment in Ethiopia, the data shows that more than half (53%) of the investment is within the administration boundary of the capital city, Addis Ababa. Oromiya regional state receives the second largest share of Chinese investment in Ethiopia. at least 36 percent of Chinese investment in Ethiopia is located in Oromiya region. About 5 percent of Chinese investment is in Amhara regional state whilst at least one percent is located in South Nations and Nationalities Peoples regional state (SNNP). Very small proportion is distributed in other regional states. See figure 17 for the regional distribution of Chinese investment in Ethiopia.

Figure 17: Geographical Distribution of Chinase Enterprises in Ethiopia (% of total Chinese Number)



4.2.4. Ownership

Figures 18 and 19 show the ownership distribution of Chinese investment in comparison with other countries of origin. While figure 18 shows the number of investment projects by ownership, figure 19 shows the percentage distribution. Of the total 5337 numbers of investments in Ethiopia, at least 70 percent are owned by single country whilst the rest 30 percent are jointly owned by more than one countries. Disaggregating the distribution of ownership between China and other countries, the story differs. Of the total 1353 numbers of Chinese enterprises in Ethiopia, 1170 (86.5%) are owned by Chinese whilst the rest 13.5% are jointly owned by Chinese and other countries. On the other hand, of the total numbers of investments from countries other than China, 2569 (64.5%) are owned by single country whilst the rest 1415 (35.5%) are owned by more than one countries.

Figure 18: Ownership Distribution of FDI in Ethiopia (Number of FDI)

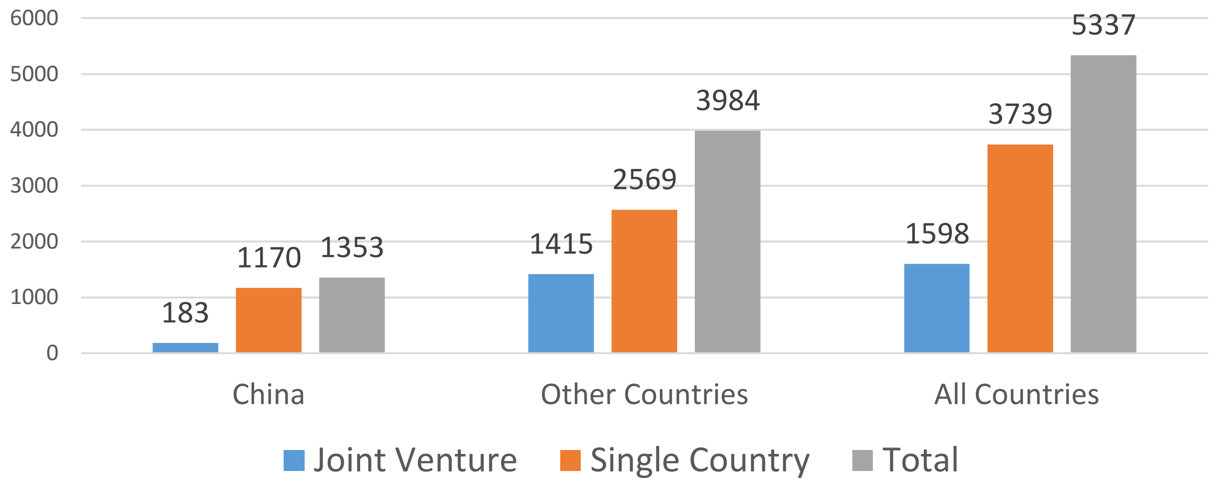
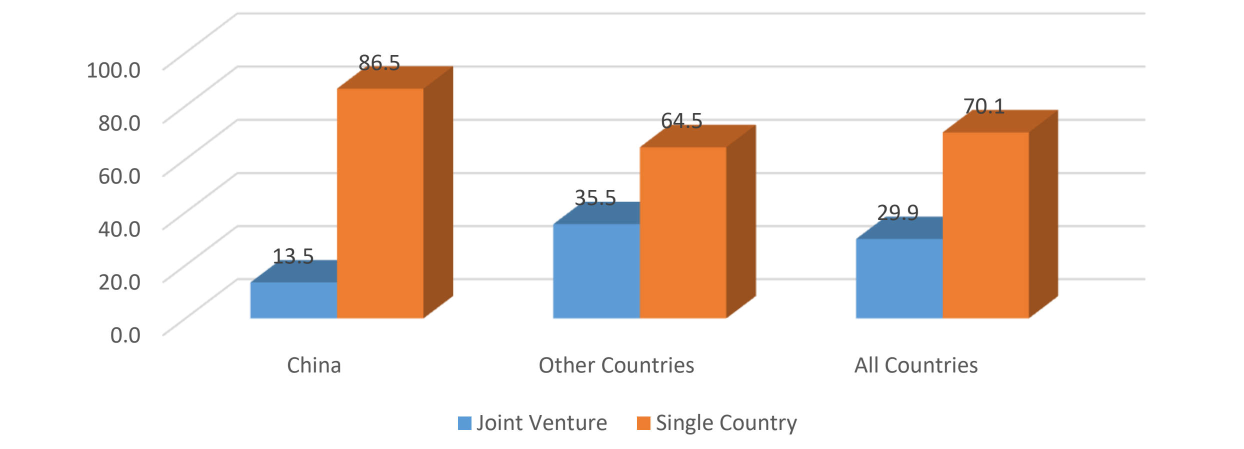


Figure 19: ownership distribution of FDI in Ethiopia by country of Origin (Percent of Total Country's FDI)



5. Analysis of the contribution of Chinese enterprises to Ethiopia's industrialization

This section presents the economic contribution of Chinese investment in Ethiopia. Similar to the previous sections, we also compare the result with other countries' FDI to Ethiopia. Four indicators are considered in analyzing the economic contribution of FDI in Ethiopia: Capital, employment, export and technology transfer.

5.1. Capital contribution

Figure 20 shows the trends on total capital registered (in thousands of Ethiopian birr) by licensed FDI projects under operation in Ethiopia from all countries between the period 1992 and 2018. There has been an upward trend in capital investment in Ethiopia from 1992 to 2018. Table 1 shows the capital registered by licensed projects that are under operation for Chinese FDI compared to FDI from all other countries of origin. Of the total 23 Chinese FDI to Ethiopia included in the analysis, Chinese enterprises registered on average 1.6 billion ETH Birr whereas FDI from all other countries together registered on average 0.2 billion ETH birr. The result indicates that Chinese capital investment in Ethiopia is significantly higher than the average sum of capital investment from all other countries of origin.

Figure 20: Trends in Registered Capital by FDI Operational Enterprises (total '000' ETH Birr per year)

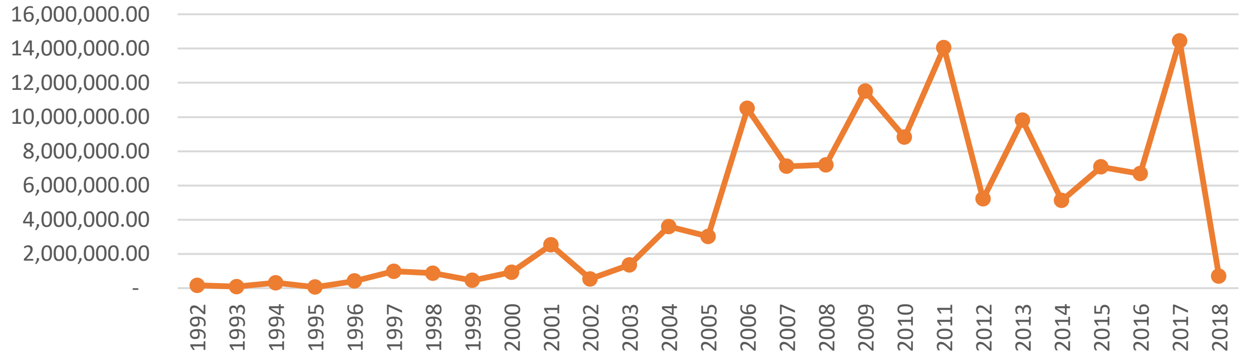


Figure 21:Trends in Capital registered by licensed FDI projects from all countries ('000 ETHB per project)

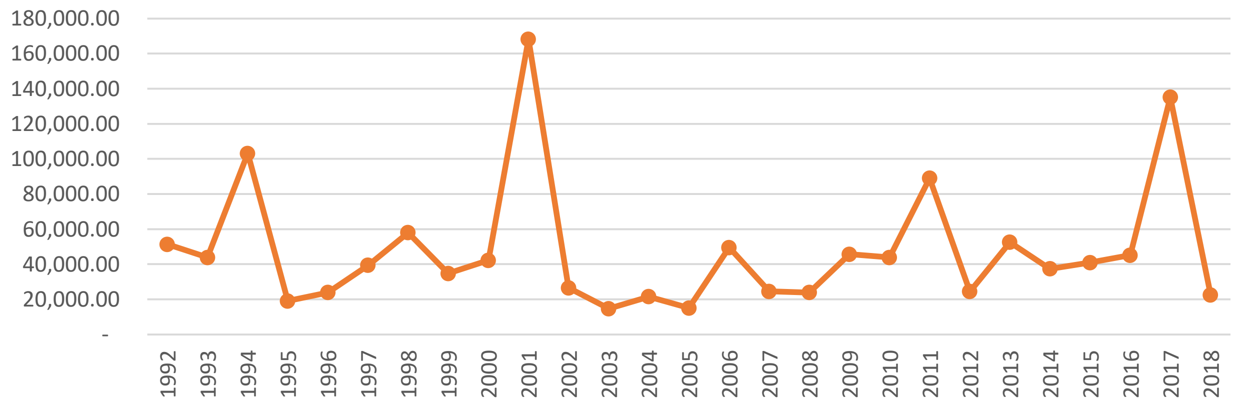


Table 1: Economic contribution of Chinese investment in Ethiopia

Country of Origin	Capital investment in millions of ETH Birr	Permanent employment	Temporary employment
China	1606.76	9279.63	5730
Other countries	183.06	532.43	633.5323
Total	249.08	925.56	868.7538

5.2. Employment

From the recipient country perspective, one of the main advantages of attracting FDI is to create employment opportunities. Figure 22 shows the trends in actual total employment created per year by FDI projects that are under operation in Ethiopia. Total number of permanent employment has generally been increased during the study period. However, there has been fluctuation. It increased from 693 in 1992 to more than 35700 permanent employment in 2008, after which it declined to 8460 in 2012. After 2012, number of permanent employments has been increasing until 2017, during which it reached the maximum number of more than 100,900 in 2017. Figure 23 shows the number of employments created per FDI projects per year. Similar trends have been observed in number of total employments created per project per year. Disaggregating the employment opportunity created by countries of origin, the data indicated that over the study period, the Chinese enterprises employed an average of 9280 permanent employment and 5730 temporary employment. The corresponding average numbers for FDI enterprises from other countries are 532 permanent and 634 temporary employment over the study periods. Table 1 shows the number of permanent and temporary employment created from Chinese and other countries FDI. The result indicated that Chinese enterprises operated in Ethiopia employed significantly higher number of people compared to enterprises from other countries. The former employed 17 and 9 times higher numbers of permanent and temporary employment compared to other countries enterprises operated in Ethiopia.

Figure 22: Employment Contribution of FDI from all countries in Ethiopia (Number of Employment per Year)

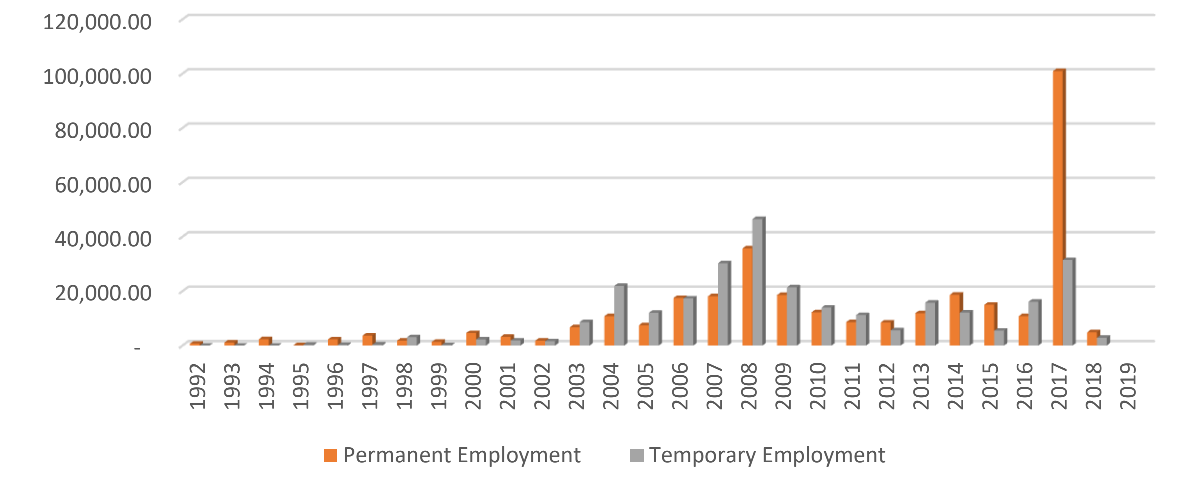
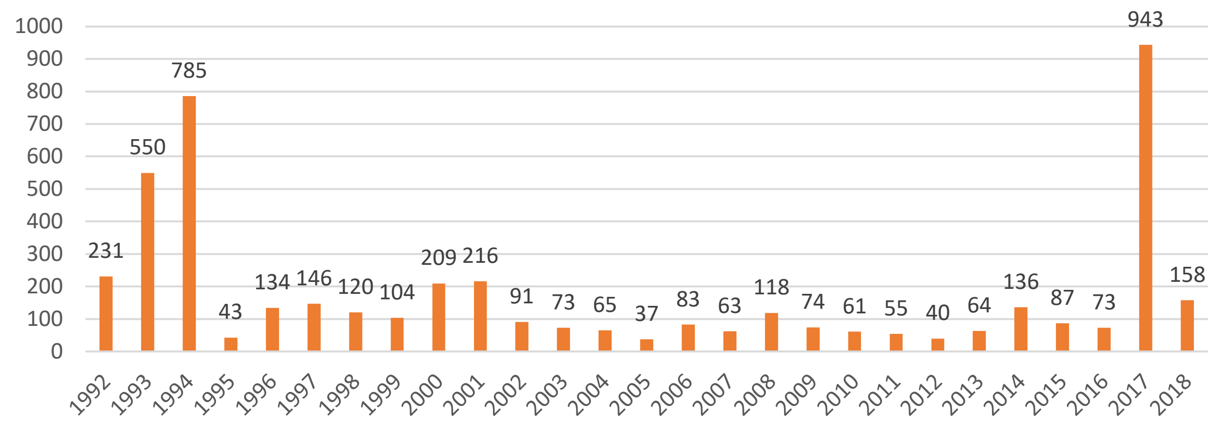
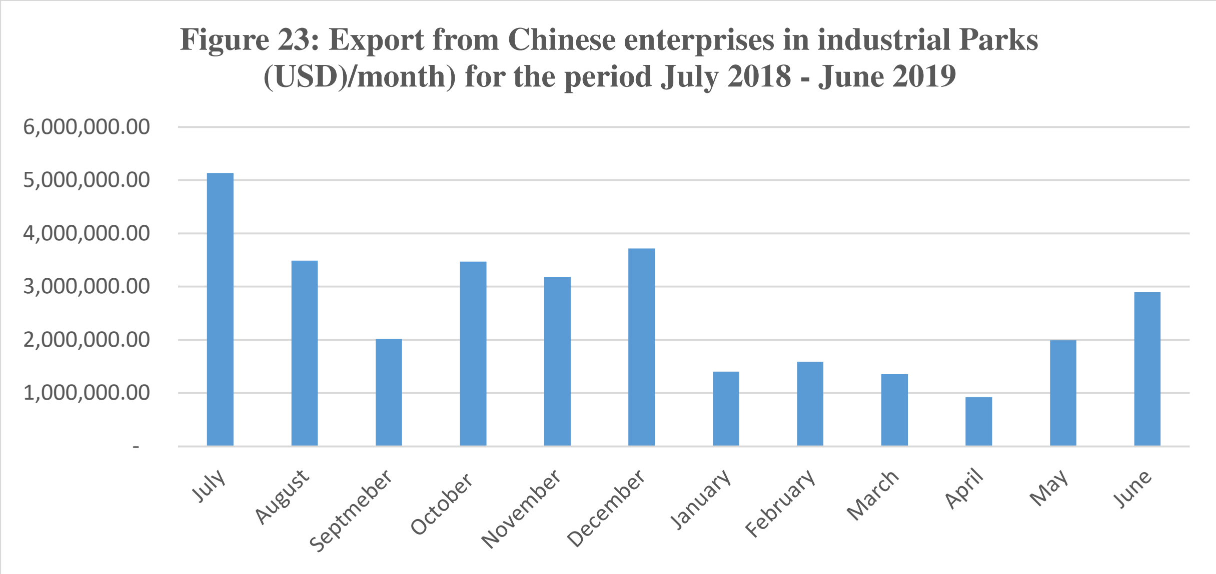


Figure 23: Number of people employed per project from FDI projects under operation in Ethiopia for the period 1992 to 2018 (number of employ/project



5.3. Export

One of the major objectives of attracting FDI is to improve the export performance of the recipient country and thereby increase foreign currency earning. In this regard, there is lack of data on the export performance of foreign enterprises operating in Ethiopia including that of from Chinese. The only data we could obtain is for one year from July 2018 to June 2019. Figure 23 shows the export performance of Chinese enterprises placed in industrial parks per month. In total, USD 31,160,482.70 is obtained from export of Chinese enterprises operating in industrial parks during July 2018 to June 2019.



5.4. Technology transfer

Another potential channel for dynamic gains from foreign direct investment is through transfers of technology, or of know-how. In this regard, Ethiopia has learned a lot from Chinese enterprises. In Ethiopia, Chinese construction companies won most of the contracts for Ethiopia's state-owned IPs. In building many of Ethiopia's state-owned IPs, technology transfer in zone construction, design, and after-care operation could be learned. Among these, the following can be mentioned.

First, with China having developed the first Industrial Park (IP) in Ethiopia, the country learned the kinds of legal and institutional services the government should provide for IP development. Drawing on these lessons, Ethiopia has established preliminary IP laws, management institutions, and OSS services. In developing its flagship state-owned IP, the Hawassa Industrial Park (HIP), Ethiopia also derived micro-level engineering, technology, and operational knowledge by coordinating with the Chinese contractor, CCECC.

Second, CCECC was responsible for the design, construction, and after-care operation of the HIP. As the main contractor, CCECC hired many local sub-contractors with the different specialties required to complete the project. The Ethiopian construction industry had benefited tremendously from working with a Chinese contractor.

Third, CCECC was also responsible for providing the HIP with after-care engineering and administrative operations for three years after its inauguration. The engineering team was comprised of Chinese CCECC engineers with expertise in IP facility maintenance. The administrative team was staffed by SEZ management experts from China's Suzhou based Kunshan Economic and Technological Development Zone (KETD).46 In order to facilitate further skill transfer, Ethiopian engineers and IP managers were paired with these Chinese experts.

Fourth, in addition to learning from China's construction standards and management, from two MOFCOM-hosted trips to Chinese SEZs in 2017, Ethiopia also learned from China's SEZ design. Interviewed participants said that they learned many important IP design lessons after visiting Chinese SEZs and comparing what they saw to the HIP.

Fifth, interviews with government officials shows that Ethiopia has also learned from the Chinese model of integrating SEZs with cities to boost urbanization and the development of corresponding industries, such as housing and restaurants.

Sixth, a study by the World Bank (2012) indicated that most surveyed Chinese firms included in the study provide formal training programs in Ethiopia. Sixty-nine percent of the surveyed Chinese companies provide formal training programs for Ethiopian workers. The survey shows that 11,314 Ethiopian benefited from training programs provided by Chinese firms. As an example, the study mentioned that Huajian and Lifan have been reported to provide vocational training to its employees, including training of local technicians in China. Skill transfers may also simply occur through labor mobility but, they remain limited if the workers are concentrated in low-skill jobs. According to data of the International Finance Corporation's Enterprise Surveys of 2006, Sixty-nine percent of the surveyed Chinese companies provide formal training programs for Ethiopian workers, whereas only 38 percent of domestic firms would invest in such programs.

6. Analysis of the key challenges to Chinese enterprises in Ethiopia

Over the past two decades, the economic cooperation between China and Ethiopia has expanded rapidly. Following this, more and more Chinese enterprises have come to Ethiopia to engage in various economic sectors. According to the information obtained from the Chinese embassy in Ethiopia, China is now the biggest trading partner, the biggest source of foreign direct investment, and biggest construction and infrastructural projects contractor. The potential for more growth for the Chinese business community in Ethiopia is quite immense. However, this potential cannot be realized without seriously addressing the critical business environment bottlenecks the Chinese enterprises are facing in their day to day activities in Ethiopia.

Various reports including the World Bank Ease of Doing Business show a deteriorating business environment in Ethiopia from time to time. Our survey on Chinese enterprises confirms that the business environment in Ethiopia has been deteriorating instead of improving. This deteriorating trend has started to seriously affect their future investment confidence in Ethiopia. Most of the enterprises we interviewed think that if the business environment in Ethiopia cannot be fundamentally improved they might be forced to postpone their investment (expansion) plan or transfer their investment capital to other competing countries with better business environment. The main and most agreed bottlenecks that require urgent attention of the government are discussed in detail below.

6.1. Safety and security issues

As shown above, until recently Ethiopia has been able to attract large projects and investments in various sectors, especially from China. One of Ethiopia's critical investment attracting factors was the maintenance of peace and security for an extended period in this turmoil Horn of Africa region. However, the recent political unrest, safety and security problems have led to damages of investors' properties and lives of their personnel. Since 2016, Ethiopia has been witnessing mob attacks on government building, horticulture farms, factories, warehouses and vehicles damaged investors' properties and confidence and their personnel assaulted. This has deprived the country the one thing that sets it apart from its neighbours, peace and stability. This is likely to have long-term implications as the political instability has perturbed existing investors' confidence and frightens away new investors.

Chinese firms have also been subjected to attacks and vandalism similar to other investors or even more targeted. In the past three years alone, more than 10 Chinese enterprises' projects suffered property damages, vandalism and personnel assaults including gunfire. Consequently, enterprises' properties have been destroyed and international orders and shipments have been cancelled, employees encountered frequent assaults, and even worse some workers were killed by unidentified people. Not only factories and properties but also the lives of workers have been and are under clear threat in several corners of the country.

As per the Chinese Chamber of Commerce report, for example, since the Addis Ababa – Djibouti Railway became operational in January 2018, incidents of theft and sabotage on the railway facilities has happened over 500 times. Moreover, the railway has been blocked for 109 times and has been completely shut down three times because of security problems. Likewise, on the border of Somalia and Oromia states, many Chinese companies had to stop construction projects or even evacuate from the area due to recurrent unrest and chaos. The Jinka –Hana road project built by a Chinese company in the SNNPR suffered multiple shootings and over ten Chinese and Ethiopian workers were killed. The project has been seriously delayed and the company has suffered heavy losses.

Moreover, as per our interview recently there was a series security problem in Adama industrial park leading to one death and injury of other Chinese experts. Some properties of the park have been vandalized. The Chinese company reported the incident to the local administrators, but they were not cooperative to solve the security problems.

From the interviews with the Chinese companies, we also find that sometimes local authorities mobilize farmers against the Chinese companies in the pretext of low compensation for land. Chinese companies are forced to employ people only from the local area and workers from other areas not welcomed. This left them with little flexibly and choice in terms of hiring labour. Likewise, according to the enterprises we interviewed artificial barriers have been set without authorization to prevent materials and manpower from other areas from entering the local areas leading to extra costs of companies. Moreover, some youth organizations intervene in the economic activity of the companies, including setting barricades on the roads to charge fees and breaking into the project sites to force the sale of raw material or obtain sub-contract work on the site at a price several times higher than the market.

The Ethiopian government has already declared that damage shall be compensated but disbursement of compensation has not happened yet or is quite slow. One of the Chinese enterprises we interviewed lost a property amounting to 40 million USD in the Amhara region due to the recent turmoil. But the enterprise has not received any compensation yet although the government promised to cover the damage enterprises.

The impact of the unrests is not restricted only to those that were physically attacked. Businesses which were not attacked but are located in the troubled areas, or even elsewhere, also suffer from loss of orders (international market or customers), decreased sales from uncertainty and slowing economy. It is reported, for example, that the sales of trucks and construction equipment have been and are now stagnant because they can become easy targets of mob attacks. Businesses are hampered not only by physical damage and the direct financial cost of repairing it but also by the fear that additional damage may occur in the future. Recent reports show that the number of Chinese businesses in Ethiopia declined due to security concerns.

6.2. Tax issues

Tax administration is another critical problem of the Chinese enterprises operating in Ethiopia. From the interviews we conducted, the key bottlenecks in relation to tax administration include the following;

(i) Ambiguity of tax rules

Chinese enterprises strongly argue that much of the tax problems come from the ambiguity of the tax rules of the country. The tax proclamations are open to various interpretations; and this provides significant discretion to the tax officers to levy varying amounts of tax. Enterprises are asked to pay more than their fair share. The fact that the tax rules and regulations offer discretionary power to tax officers means that it also opens doors to bribery and corruption. If bribed, tax officers interpret tax regulations in favour of leniency.

(ii) Non-transparent and time-taking tax appeal process

The tax appeal process is not only non-transparent and time-taking but it also does not follow a credible review process. The tax review committee is affiliated to the tax authorities, which makes it difficult to produce an independent review. Consequently, enterprises are forced into negotiating with tax officers. This means that tax officers do not have the incentive to make the tax appeal process transparent, short and independent.

(iii) The auditing system lacks international standards

According to the enterprises we interviewed, the audit practice in Ethiopia does not strictly follow international standards. This has at least two impacts. First, since most of these companies are international, it is in their interest to follow an international standard audit system so that their financial system conforms to the international practice. Second, it becomes difficult to determine about tax problems and other obligations if the audit system is not international standard. Enterprises and tax authorities cannot agree on a system of finances that are not internationally accepted practices.

(iv) Taxation irregularities

From the interviews we conducted with the Chinese firms we find that they are unreasonably punished by the tax authorities as a result of imperfect invoice management system for example for receiving illegal invoice from fake local suppliers instead of investigating the source of the fake invoice. Sometimes legal representatives of the enterprises are put under arrest due to tax issues to force companies pay tax. In relation to VAT, there are two challenges. The first is that Chinese enterprises that take contracts from state owned enterprises are asked to pay VAT before they receive payments from their employers. Employers usually pay the Chinese contracts late. In the absence of payment from employers, Chinese firms find it difficult to pay their VAT. The second challenge is there is also delay (sometimes up to 2 years) in VAT refund, which leads to cash flow problems for some companies.

(v) Customs

The other key challenge relates to trade facilitation. Slow customs and technical control clearance due to burdensome inspections procedures are major problems. First, it takes time to get clearance for intermediate inputs. The interview with enterprises reveals that part of the problem is the lack of qualified customs officers to inspect and give decision promptly. As an example, valuable time will be lost until the customs officers establishes whether an imported item is a final good or an intermediate input. Customs inspection process is quite slow. Second, Ethiopian Customs Commission's (ECC) appeal process management (APM) is inefficient. The appeal process is complex and requires traders to appeal only after paying above 50 percent. As a result, traders tend to resort into rent seeking activities such as bribing. Because they fear that if a case ends up at court, then it would take a long time. Third, customs procedures change quite frequently, which creates uncertainty and hinder trade facilitation, corruption as a result of unclear procedures, and the customs valuation procedure. In Ethiopia, invoice value will not be accepted if it is considered too low compared to a database maintained by Ethiopian Revenue and Customs Authority. Some investors confirmed that their invoice is rejected wrongly. The challenge for the government side is that often the custom related privileges are abused and even investor admits that there are those who abuse the system. For manufacturing, lack of qualified professionals who understand the sector has been cited as a serious problem in various public bodies including customs office. This is particularly true as new industries emerge.

6.3. Foreign currency shortage

The current foreign exchange regulation fully liberalizes current account for international payments. The regulation allows payments for all kind of imports with the exception of goods that are supposed to be detrimental to the health of the public and security of the nation. Payments for imports can be made by Letter of Credit (LC), Cash Against Documents (CAD) and advanced payment (TT). Although the National Bank of Ethiopia is responsible for legal framework, commercial banks handle the foreign exchange demands requested by importers. Importers are required to provide import license, industry license/investment license accompanied by proforma invoice or contracts from suppliers stating the type of commodity, quantity of the good, unit price and FOB value.

Importers can get the amount of foreign currency that they requested for their imports based on the foreign exchange allocation procedure. The Commercial Bank of Ethiopia have setup a committee to approve foreign exchange requests according to an expert in the bank. There is some element of prioritizing inputs for the manufacturing sector, fuel and pharmaceutical products. Experts at the Commercial Bank of Ethiopia also stated that they serve client on first-come, first-served basis.

But in practice Ethiopia's foreign currency supply and administration is in jeopardy adversely affecting the businesses and the whole economy at large. One manifestation of this challenge is shortage of forex supply. First, it has become extremely difficult to access foreign currency to import raw and intermediate materials. Second, like other foreign companies, Chinese enterprises could not easily and swiftly repatriate their profits in foreign currency form. As a result, some of them have accumulated a lot Ethiopian Birr. Third, some Chinese firms that are managing projects in Ethiopia (such as the railways) could not get access to forex to buy spare parts for the train cargos.

Another dimension of the challenge is a long queue to access foreign currency. Enterprises confirm that there is lack of transparency in the foreign currency allocation process. It is not possible to know how long it will take (there is a queue). The process can take from three months to one year. As the investor is unsure about when her/his request will be approved she/he has always to be ready. This process ties up capital that would have been used for other purposes. The long waiting time means prices (including the exchange rate) will change increasing the cost of waiting.

6.4. Labour related problems

Ethiopia's another critical comparative advantage in attracting investment is its large youth population and easily trainable workforce. Current reports show that of the 105 million estimated population, about 40.5% are under age 15 and 30% youth age 15 to 29. In the last two and a half decades Ethiopia has heavily invested in human capital development. Ethiopia has registered remarkable progress in terms of expansion of primary education, TVET and secondary education, the establishment of industry institutes (such as TIDI, LIDI, MIDI, EKI, etc), and expansion of higher education to improve the supply of basic skills highly needed for economic transformation. Despite all these improvements, enterprises still face serious workforce related challenges. The main challenges are summarized below.

(i) Poor work culture and discipline

For a country transitioning from traditional sectors (such as agriculture) to modern sectors (such as manufacturing), labour discipline is a big issue. Labour should not only be trained but it should also be disciplined. Some of the major labour discipline problems include the following:

- *Time management* - workers come to their work place late and leave early.

- *Absenteeism* - significant and repeated absenteeism especially during Ethiopian holidays without notice is rampant. According to the firms we interviewed, a typical worker enjoys ungranted leave for at least three days – eve, holiday and one day after the holiday. This is common practice in public offices, and it usually is unpunished.
- *Overtime* – workers are unwilling to work for extra hours when the factory has pick demand. Workers perception is that enterprises pay less in wages especially when it is over time; and they would rather prefer to participate in social events than work in factories.
- *Worker-management relationship* - the relationship between management and workers seems to be rough. There is no institutionalized regular communication and information flow between top management and employees. Such institutionalized communication is a crucial medium for workers to ask questions, report problems to their bosses and make any suggestions. On the other hand, it also helps top management address workers' questions and concerns systematically, convince workers to embrace new ideas and changes and get involved in the process.
- Labour strike – instead of trying to present their issues and problems to the company management, workers usually resort to strikes without notice. Worker strikes are rampant these days, and most of the strikes take place abruptly without prior notice. Workers can come or send their representatives and present their case to the management before they go on strike.

(ii) High labour turnover

According to the interviews we conducted in various sectors, we observed that the manufacturing sector suffers most from recurrent worker turnover and short-termism partly because workers believe it is a low-paying sector (especially for production workers) and partly because it requires significant discipline. As Addis Ababa and other secondary cities in Ethiopia are quickly urbanizing, the service sector is growing rapidly and tends to pay better than the manufacturing sector. In addition, there are a lot of NGOs and international organizations that offer better pays. As a result, young workers do not settle for long in factories. They change jobs frequently. This makes production at full capacity difficult and increases the cost of training new workers every time. Self-employment being a competitor choice and the fact that Industrial jobs have health risks are also important factors for workers not staying long in industrial jobs.

6.5. Infrastructure related problems

Most of the infrastructural problems are related to power supply. Some of the Chinese enterprises we interviewed do not have access to power supply. Until they are connected, they are using their own generators and some of them are using rented generators. They explained that this has led them to incur additional costs and loss of international orders as they cannot meet delivery time. And those that have access to electricity, their concern is related to recurrent power supply interruptions.

The second aspect of infrastructural problem that Chinese enterprises raise is that infrastructural agreements and commitments are not strictly honoured by the EIC (or government of Ethiopia). EIC on behalf of the government of Ethiopia enters into agreement with investors to provide all necessary infrastructures including power, road, and telecom up to the fence of the investment. But extended delays and sometimes not honouring the agreement at all has become common. This has frustrated Chinese enterprises.

7. Analysis of opportunities of Ethio-China investment ties

7.1. Untapped opportunities to attract more and quality investment from China

Chinese untapped investment potential is immense in relation to what has come so far to Ethiopia and the African continent at large. Chinese direct investment in Africa is a small part (less than 3%) of China's total overseas direct investment. Ethiopia's share of Chinese capital stock in Africa is below 5%. This means there is a large room to increase their share of Chinese overseas global investment.

Brautigam, Diao, McMillan and Silver (2018) shows that Chinese FDI in Africa is starting to diversify in terms of sector and location. Early FDI by China in Africa was intimately linked with China's demand for natural resources and was primarily done by China's State Owned

Enterprises (SOEs). While mining and construction still account for the bulk (54%), the stock of manufacturing FDI has increased to 13% of China's FDI stocks in Africa in 2015. Concomitantly, Chinese FDI in Africa has started to diversify away from resource rich countries into other economies including Ethiopia.

The Chinese government 'go global' policy to encourage Chinese to invest overseas is another opportunity for Africa. According to Brautigam et al. (2018) the Chinese government together with the China Council for the Promotion of International Trade (CCPIT) has introduced a number of incentives which are intended to encourage domestic firms (both public and private) to invest overseas. The rational for encouraging overseas investment are the large amounts of foreign reserves accumulated by China, Chinese industry's need for raw materials, and a desire to make Chinese firms competitive with mostly Western multinationals. Moreover, the rising labor cost in domestic market is forcing more and more Chinese firms to outsource labor intensive manufacturing operation in Africa and the rest of developing world.

Increasing Chinese investment flow to Ethiopia is a good example of sectoral and locational diversification of Chinese investment in Africa. The China government has been keen to encourage Chinese businesses to invest in Ethiopia. Chinese FDI stock to Ethiopia increased from 1% of total Chinese FDI stock to Africa in 2003 to 5% in 2017 whilst FDI flow increased from 1 percent in 2003 to 14 percent in 2017. Unlike to other several African countries, Chinese investment in Ethiopia is not concentrated on the extractive sector. Instead, more than 70% of the Chinese investment in Ethiopia is going into the manufacturing sector. The increasing focus on productive sectors in high-growth countries such as Ethiopia offers the potential to expand manufacturing and agricultural exports and develop infrastructure (Brautigam et al. 2018).

7.2. Opportunities for Chinese enterprises to enter and grow in Ethiopia

Ethiopia still holds a special place for Chinese enterprises. The literature shows that the main drivers of Chinese investment in Ethiopia are to take advantage of (i) better investment climate including government support and commitment, infrastructure and incentives (ii) growing domestic demand and market (iii) cheap and easily trainable labor (iv) maximize cross border investment incentives (e.g. AGOA and EBA) and (v) stable political climate and peace although this is being challenged in recent years. The special political ties between the Chinese and Ethiopian government is also another crucial driving factor of Chinese investment in Ethiopia.

As a result, many Chinese enterprises have operated in the Ethiopian market for more than 20 years. China is already the first largest source country of FDI in Ethiopia. Chinese investors play pivotal role in the emerging industrial parks in Ethiopia. They are already very visible in the leather and textile sectors. Chinese businesses are engaged in diversified sector and want to diversify even more. They have shown increasing interest in investing in agro processing sector (for example, livestock, bamboo, coffee) as a way of adding value to the agricultural products and export them. Many of them have a long-term perspective and hoping the business environment and political stability of the country will improve after elections. New and existing Chinese firms keep at identifying and grabbing untapped opportunities to enter into and grow in Ethiopia.

Below we highlight some of the key and forward looking sectors that might offer significant opportunities for Chinese enterprises to diversify and grow as well as Chinese government recent initiatives to realize this.

7.2.1. Bamboo sector

We think that the bamboo sector offers a great opportunity both at the global and Ethiopia level. International trade in bamboo and rattan stands at more than 2bn USD annually. According to the International Network of Bamboo and Rattan (INBAR), the global bamboo economy is now valued at $60 billion and rising. The global export market was valued at 2bn USD in 2011.

Ethiopia benefits from having around 1 million hectares of bamboo, which is two-thirds of all the bamboo in Africa. Ethiopia plans to double coverage to 2 million hectares by 2019. The bamboo sector can satisfy both export market and domestic use. Although the bamboo sector holds a great potential, it still remains untapped. Currently there is a public-private partnership effort between Africa Bamboo (a private enterprise) and German Development Corporation, which plans to invest about €10 million over the next five years, to supply to the EU and US markets. They planned to export 100,000m2 of bamboo in 2014, rising 500% to 500,000 in 2016. Exporting to Europe and US – looking to tap into the fast growing wood furniture and decking market.

While Ethiopia has this immense bamboo resource, China has the technology (modern equipment to manufacture bamboo products), the capital, and the international market. Ethiopia and China can complement their comparative advantages to produce high quality bamboo products for international and domestic markets. The Chinese government has already shown interest to promote the bamboo sector in Ethiopia. In this regard, China wants to build China-Africa bamboo centre in Ethiopia.

7.2.2. Livestock sector

Ethiopia has one of the world's largest livestock population with around 58 million cattle (the largest in Africa and 6th in the world), 29 million sheep (3rd in Africa and 10th in the world) and 30 million goats (3rd in Africa and 8th in the world). However, the Ethiopian livestock sector largely involves small cattle farmers without many largescale ranches. The absence of commercial farms consistently supplying for the meat and also leather industry is an important condition for the growth of the meat industry. The weak meat industry is also attributed to low off-take rates, low meat consumption and low meat exports.

Meat consumption is likely to increase in Asia (especially China and India) and the Middle East. Meat consumption in Ethiopia is also on the rise. The rising global and national demand offers a great opportunity for Ethiopia to promote new investment in commercial farming and abattoirs. Investment land can easily be identified in areas where predominantly there are more animals per square meter. Opportunities for significantly improving quality are available for the meat and milk industries through modern techniques of husbandry, vaccination, favourable grazing environment, and better feed. Quarantine and inspection infrastructures are also needed. Investors may maximize their benefits by taking an integrated (or comprehensive) approach of developing meat, dairy and leather industry.

Chinese investors are well placed to exploit this opportunity. The government of China is encouraging Chinese investors to invest in the livestock sector as a way to improve meat export from Ethiopia to China. The rational is that Chinese society demand for meat (beef) is increasing through time and as a result of improvement in income. Ethiopia is a big potential to partially meet this demand. The Chinese government is supporting a study on how to improve the livestock industry (particularly the diseases) in Ethiopia. It is determined to boost the livestock sector. Together with UNIDO they aim to build pilot area. A Chinese company namely CGCOC is preparing to establish an integrated livestock industrial park in Awash area with a Chinese grant. The CGCOC Group has agreed to establish a fully integrated livestock and meat processing plant with an annual slaughtering capacity of 300,000 castles and 3 million sheep in Awash, Fentale.

7.2.3. Logistics sector

Without world class logistics services, it is difficult to have a thriving export manufacturing sector. Logistics cost in Ethiopia accounts 20 to 30 percent of the total cost. Trade costs in Ethiopia are very high and time required to trade is long. In other words, Ethiopia’s trade logistics performance is way below its comparator countries in Africa (Kenya, Rwanda, Tanzania and Uganda). Ethiopia’s export transit time is about 42 days, which is much higher compared to even its landlocked comparator countries such as Rwanda and Uganda. The time it takes to export is about twice as long for Ethiopia as it is for China, Vietnam, and Kenya. Similar stories emerge if we look at the cost side. Ethiopia’s Cost to export a 20-foot container is 2660 USD. The same figure is 600USD and 2350USD for Vietnam and Kenya. This means that Ethiopia pays an additional cost of 310USD per 20-foot container compared to Kenya. And an additional cost of 2060USD compared to Vietnam. The impact of this cost increment is reflected in lowering Ethiopia’s competitiveness in the global market.

The government’s recent approach to alleviate the high inefficiency in the logistics sector is to open up the sector to foreign operators. This is expected to bring both capacity and technology which will improve the logistics services efficiency. Chinese enterprises who are interested in the logistics sector can seize this opening up opportunity; thus, address the structural and logistical constraints that limit the competitiveness of the export sector. A Chinese logistics firm by the name SinoTrans Logistics is already moving in and exploring the opportunities within the Ethiopian logistics sector.

8. Recommendations

Chinese investment in Africa has started to diversify away from resource rich countries into other economies including Ethiopia and from extractive sector towards manufacturing. Through its 'go global' policy, China is encouraging its businesses to invest in Africa and particularly has been keen to invest in Ethiopia. Chinese enterprises have played unique and indispensable roles in Ethiopia in various ways including infrastructure development (i.e., roads, highways, railways, bridges, airports, etc), job creation (i.e., investment in productive sectors), tax revenue, and technology transfer.

Chinese untapped investment potential is, however, immense in relation to what has come so far to Ethiopia. Chinese investment has significant scope for diversification of exports particularly agriculture and manufacturing. Chinese enterprises can be instrumental to accelerate Ethiopia's transition from a predominantly low-productivity agriculture-based economy towards a higher-productivity manufacturing and export-oriented economy provided that a right policy and conducive business environment is in place.

However, despite encouraging investment inflow over the last decade and half, the recent couple of years has shown a declining trend in Chinese investment. Above all more investment will come only if the existing investors are happy about the investment environment. Otherwise, the existing one will leave the country let alone to attract new ones as they could not convey good stories to potential investors. In other words, Ethiopia must quickly address the existing obstacles. Based on the analysis of challenges and perceived obstacles facing Chinese enterprise in Ethiopia and untapped opportunities, this study recommends the following areas for policy adjustments to facilitate more Chinese investors coming into Ethiopia and existing to expand and grow so that Ethiopia can reap the benefits it needs to further its development path.

8.1. Address security and political instability problems and restore businesses confidence

(i) Improve security

The current slowdown of the Ethiopian economic growth can be traced largely to an increased level of uncertainty which damps investor psychology and makes business decisions uncertain. This has to be reversed quickly and sufficiently by taking the following measures. First, political commitment has been a key driver of investment flow to Ethiopia. Following the recent waves of political instabilities and changes in government leadership, investors seem to wonder if Ethiopia is still committed to investment promotion and protection. To dispel this uncertainty, the government (preferably the Prime Minister himself) need to publicly state its unwavering political commitment towards investment and the protection of property rights against expropriation and wanton destruction and violence. Such clear and high-level official statement of solid commitment supported by concrete policy measures to realize them will positively affect the public's and investors' mind-set in three steps, first by the announcement effect (immediate), second by positive reaction to an effective implementation of promised policies (mid-term), and third by producing intended economic results (long-term).

(ii) Compensate damage

The second aspect of restoring business confidence, the lack of which causes slow investment flow and industrialization and economic activity in general, is fully compensating the physical damage incurred by businesses during the turmoil. Hence, the first task of the government toward normalization of business confidence should be to compensate for the physical and psychological (market) damage incurred by enterprises due to the recent turmoil. The Ethiopian government has already declared that damage shall be covered but disbursement of compensation seems slow. To properly execute compensation, several issues must be considered: (a) the scope of compensation must be determined and the required size of compensation needs to be estimated. For example, will the government assist only those companies that were directly attacked and incurred visible damage by the mob or will it more broadly support businesses whose sales went down significantly due to the turbulence? In either case, it is necessary to prove that the damage is due to the unrest and not because of incompetent management. After defining the scope of compensation, the required amount of compensation should be estimated as soon as possible and it must also be decided whether claimed damage is compensated fully or partially. (b) The financial source(s) of compensation must be identified. One good source of funding to cover the compensation will be to use any large fund under state control (e.g. pension contributions) which needs to be redeemed only in the long run. (c) The method of compensation should be decided. While the repair of physical damage should be supported by direct cash grants by the full amount of the assessed damage, soft policy loans with low interest and relatively long maturity may be appropriate for firms with no physical damage but whose market shrunk significantly after the turmoil, (d) Compensation scheme must be implemented in a way that is fair and does not further destabilize market psychology. (e) if any large enterprise which has serious impact on the national economy fails, but if there is a chance for revival under proper management, the government may temporarily nationalize it, introduce bold restructuring including overhauling the management, introducing efficiency and restoring it to profitability, then return it to private ownership.

(iii) Synergy and consistency

The role of regional or city or local governments for smooth private business operation and facilitation is critical. The government should create more clarity on institutional arrangements by defining roles of and interface between city, regional and the federal governments. The federal and regional governments should strengthen coordination and synergy in incentives management, land approval process, and in the provision of other aftercare services.

8.2. Streamline tax and customs issues

Tax regulations need to be consistent, simple and transparent. The current tax regulations have normative aspects and provide some degree of discretion to tax officers. This has led to various abuses and enforcement problems. Moreover, whenever tax disputes arise they must be investigated by an independent and professional arbitrator. Tax disputes should not be treated through the normal court process. Independent and professional tax (other business) arbitration is required to expedite the appeal process and resolve the dispute.

The second tax challenge that needs immediate attention is related to VAT payment. There is usually delay in settling payment when Chinese enterprises take business contracts from the Ethiopian state owned enterprises. The contractors (Chinese enterprises) are asked to pay VAT before they have received payment from the Ethiopian employer. So Chinese enterprises request two changes in relation to this: (a) Chinese enterprises should be allowed to declare and settle VAT after they actually receive payment from their employer; and (b) the contractor should not be fined for the employers delaying of payment for VAT.

At ECC level, we suggest the following actions to alleviate the slow customs and declaration process

- ECC should automate its system
- ECC should avoid unjustified inspections of Transit Cargo
- ECC should improve its risk management system and introduce it in other border control agencies

8.3. Improve labour issues

In section six, we showed that low productivity (efficiency), high labour turnover, and low industrial culture and discipline are the main binding constraints Chinese enterprises. The educational background of workers is may be sufficient for those that are working in the manufacturing sector. For example, high level of education is not required for most of the apparel industry. Plus, most workers are easily trainable. What is lacking most is industrial work culture and discipline. Most workers come from rural areas that have limited exposure to urbanite life and industrial discipline. In this regard, we forward the following suggestions improve the industrial culture and discipline of workers.

(i) Provide soft skill training

Experiences from around the world show that soft skill training is the main solution to lack of work discipline, time management, knowledge of duties and responsibilities, and work stability problems. Workers need to be given sufficient training on soft skills. In industrial parks, the government through EIC (labour units) provides services of employee recruitment and soft skill training at job centres. These services can be expanded to enterprises that are residing outside the industrial parks.

(ii) Hire local HR manager

Employers are expected to follow the Ethiopian labour law in hiring, treating and firing workers. It is also important that employers understand the culture and psychology of their workers. For these two reasons, Chinese enterprises will be better of hiring local HR managers to manage their local staff.

(iii) Chinese enterprises should continue with improving their work environment to create friendly and safe working environment

One of the major reasons for high labour turnover is that workers perceive that industrial jobs are dirty and dangerous. If workers are provided with proper health and safety systems, labour turnover is expected to be lower. The Ethiopian government should encourage, reward or subsidize firms with a great working environment. We find that some Chinese firms are taking significant measures to improve their working environment. For example, Di Yuan Ceramics introduced new and better technologies that significantly reduce dust exposure to workers.

(iv) Improve worker welfare

We identified that wage is still low quickly rising in Ethiopia. High cost of living due to rising housing, transport, and meal costs results in high labour turnover and this puts pressure on wages to rise without improvement on productivity (efficiency). Due to higher salaries workers also prefer to go to international organizations, informal sector and self-employment, which leaves quite limited labour flow to the manufacturing sector. In this respect, we recommend enterprise to introduce the following schemes to improve welfare of workers:

- The government need to encourage enterprises, especially those that are in industrial parks and clusters, to provide accommodation (dormitory) to workers. The government can help by providing land or by providing cost-sharing schemes.

- Providing meals to workers makes a lot of difference in improving worker welfare. It is also believed to improve retention and productivity.
- The government of Ethiopia need to enforce health and safety standards at work place by all enterprises.

(v) Introduce tripartite arrangement

Conflicts and disputes between management and employees may better be resolved by a tripartite resolution system that involves employee, employer, and government (represented by MoLSA or BoLSA). The tripartite arrangement can also help reduce the frequent and an unannounced labour strikes.

8.4. Improve the deficiency in power supply

Above we have shown that Chinese enterprises raise concerns that infrastructural agreements including power, road and telecom commitments are not respected by the government. Lack of power supply and recurrent power interruption is particularly hindering many enterprises from running at full capacity. This leads to material and equipment damages and loss of international orders, which has frustrated Chinese enterprises. The government need to give special attention to address the problem in the supply of power. A swift response is rendered to the requests of dedicated power line from many of the emerging industrial parks. In this regard, the government can replicate its success in the Hawassa industrial park.

8.5. Sufficiently exploit the development impact of the Chinese enterprises

With appropriate policies, FDI can benefit host country in multiple ways including employment, capital inflow, exports and technology transfer. As discussed above the impact is yet to be boosted due to lack of proper policy instruments and institutional capacity. Some local firms and industries find it difficult to compete with Chinese firms. Below we highlight some proposed actions to maximize the benefits and reduce the associated risks.

- Build the capacity of national institutions administering FDI and improve their coordination

  - Improve the monitoring and evaluation capacity of relevant government agencies (tax office, Custom, EIC …)
- Address the crowding out effect by way of improving the capacity of domestic firms, thus, they become competitive not only in domestic market but also exports
- Improve the partnership between Chinese and Ethiopian firms, thus, enhance knowledge and technology transfer through;
  - Joint venture
  - Backward and forward linkages
- Establish (Ethio-China) joint committees to identify potential sectors for joint investment and solve recurrent problems
  - For example, government to government and chamber to chamber relations
- Provide additional incentives for export-oriented firms, engage in technology transfer through supply linkages or joint venture
- Encourage re-investment by making the return from local economy more appealing and restoring business confidence

References

Deborah Brautigam, Xinshen Diao, Margaret McMillan, and Jed Silver (2017), ‘Chinese Investment in Africa: How Much do we Know?’ PEDL Synthesis Series† | No. 2, center for economic policy research center https://voxdev.org/topic/finance/chinese-investment-africa

Matthias Busse, Ceren Erdogan, and Henning Mühlen, (2014), ‘CHINA'S IMPACT ON AFRICA – THE ROLE OF TRADE, FDI AND AID’, working paper 206, IEE, BOCHUM 2014

National Planning Commission (2016), ‘Growth and Transformation Plan (2015/16 – 2020)’

OECD, AfDB, UNDP and ECA (2013) African Economic Outlook 2013. Paris: Organization for Economic Co-operation and Development

UNECA (2013) Economic Report on Africa 2013. Addis Ababa: United Nations

UNCTAD (2013) World Investment Report 2013. New York and Geneva: United Nations