Exploiting business opportunities in the Ethio-China relations[1]

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Introduction

Foreign Direct Investment (FDI) can generate multiple benefits to the host country, among others, as a source of capital, technology transfer, export and employment. However, the benefits from FDI are not automatic and FDI is not risk free. The global experience shows that with adequate policies and institutional capacity, FDI can provide significant economic and social benefits to the host country.

Ethiopia has become the preferred destination of FDI in the sub-Saharan Africa despite some slowdown in recent years due to political unrest. 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). In Ethiopia, China is the first largest FDI source country. Investment from China has increased substantially over the past decade, with more than 70% of it going into the manufacturing sector. However, Chinese untapped investment potential is immense in relation to what has come so far to Ethiopia and the African continent at large.

This article tries to highlight, on the one hand, the immense untapped investment potential from China that can be attracted to Ethiopia and, on the other hand, the opportunities that Ethiopia could offer to Chinese investors to invest and grow. It also provides some recommendations on how to attract more investment from China and maximize the benefits from their presence in the economy.

Emerging opportunities in attracting more investment from China

The Chinese government's 'go global' policy to encourage Chinese enterprises to invest overseas is a great opportunity for countries like Ethiopia. China has introduced several incentives that are intended to encourage Chinese firms to invest overseas. The rationale for this include: large amounts of foreign reserves accumulated by China, Chinese industry's need

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for raw materials, and a desire to make Chinese firms globally competitive. Moreover, the rising labor cost in China is forcing more and more Chinese firms to outsource labor intensive manufacturing operations in Africa and the rest of the developing world.

Another opportunity is that Chinese FDI in Africa is starting to diversify in terms of sector and location. Early FDI by China in Africa was closely 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 (Brautigam, Diao, McMillan and Silver, 2018). The special political ties between the Chinese and Ethiopian government is another crucial driving factor of Chinese investment in Ethiopia.

Opportunities for Chinese enterprises to diversify investment and grow in Ethiopia

On the other hand, Ethiopia offers significant opportunities for Chinese enterprises to diversify and grow. Next, we highlight some key and forward looking sectors whereby such opportunities can be realized.

Bamboo sector: According to the International Network of Bamboo and Rattan (INBAR), the global bamboo export market was valued at 2bn USD in 2011. Ethiopia is endowed with around 1 million hectares of bamboo, which is two-thirds of all the bamboo in Africa. The bamboo sector holds a great potential for export market and domestic use, but it remains untapped. China has the technology (modern equipment to manufacture bamboo products), the capital, and the international market. Ethiopia and China can, thus, 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 center in Ethiopia.

Livestock sector**:** Ethiopia has one of the world's largest livestock population. However, the sector largely involves small cattle farmers without many largescale ranches. The absence of commercial farms consistently supplying for the meat and the leather industry is an important impediment for the growth of both the meat and the leather industry. Meat consumption is on the rise in the domestic market as well as in Asia (especially China and India) and the Middle East. The rising global and national demand offers a great opportunity for Ethiopia to promote new investment in commercial farming and abattoirs. The government of China is encouraging Chinese investors to invest in the livestock sector to improve meat export from Ethiopia to China, thus, meeting the increasing beef demand of Chinese society. It has already started supporting a study on how to improve the livestock industry (particularly the diseases) in Ethiopia.

***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. Ethiopia's trade logistics performance is way below its comparator countries in Africa (Kenya, Rwanda, Tanzania and Uganda). 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. For example, a Chinese logistics firm by the name SinoTrans Logistics is already moving in and exploring the opportunities within the Ethiopian logistics sector.

Recommendations

The Ethiopian government needs to tap the emerging opportunities from China to attract more and quality investment. Among others, this requires improving the existing business environment and particularly addressing the problems related to security and political stability, tax and customs administration, infrastructure supply (especially power) and labor issues. But attracting FDI is only the first and necessary step and may not be sufficient to secure the benefits from it. Thus, the government needs to put in place proper policy instruments and build institutional capacity to maximize the benefits and reduce the associated risks.

- Build the capacity of national institutions administering FDI and improve their coordination as well as monitoring and evaluation capacity of relevant government agencies
- 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 (including incentives), thus, enhance knowledge and technology transfer through joint venture and backward and forward linkage programs
- Establish (Ethio-China) joint committees (for example, government to government or/and chamber to chamber relations) to identify potential sectors for joint investment and solve recurrent problems

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