POLICY BRIEF

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A Comparative Analysis: Chinese and Indian Exim Bank Finance in Ethiopia

Zhengli Huang and Pritish Behuria

POLICY POINTS

Chinese Exim Bank, should develop a different feasibility study method for proposed development projects, with a loan structure that has a more balanced risk distribution among institutions.

The Indian Exim Bank should identify how India's development partners can connect with prominent Indian firms to globalize their activities in strategic investments that can support economic transformation.

Recipient governments should establish research teams to identify companies and funding mechanisms that may be best suited to achieve desired development objectives.

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OVER THE LAST DECADE, DEVELOPMENT ASSISTANCE has increasingly acknowledged the need to 'do development differently' (e.g., Problem Driven Iterative Adaptation – PDIA) and 'think and work politically,' rather than proposing one-size-fits-all solutions to solve complex development problems. A key implication of this recent trend in development thinking is to highlight the centrality of politics in shaping development outcomes and the urgent need to reconfigure development policies to improve outcomes within existing political contexts. Politically-informed policy analysis has begun to inform Western donor programming in recent years, with varied outcomes. For emerging donors, there is a less formal embrace of such approaches. This is primarily because India, China, and the like rarely propose one-size-fits-all solutions and (officially at least) provide support depending on recipient demands.

From the lens of OECD standards, China and India's Exim Banks use different sets of tools in implementing development finance in African countries. One significant characteristic distinguishing emerging donor finance from that of traditional donors is how the boundary between export financing and development assistance is blurred. China and India's Exim Banks operate both as Export Credit Agencies and Aid Agencies.

Officially, both China and India consider African countries to be 'development partners' rather than recipients of their foreign aid. Yet, there is a dominant view that emerging donors' expanding economic ambitions with Africa are simply driven to extract natural resources. Ethiopia's case counters this argument because although Ethiopia is not a resource-rich country it receives significant loans from China and India. The Ethiopian government is often cited as being among the few governments that actively develop strategic engagements with donors to direct funding to key developmental objectives. Comparing Exim Bank investments shows how the banks both facilitate economic interests from the lending countries and fulfill the development agendas in the borrowing countries at the same time. It also shows how the Ethiopian government has, and must continue, to retain a strategic engagement with donors.

INFRASTRUCTURE FINANCE: CHINA EXIM BANK IN ETHIOPIA

BEFORE UNDERGOING SEVERAL transitions, the economic partnership between China and Ethiopia began as a political alliance in the 1960s. Economic ties between China and Ethiopia strengthened in the mid-1990s when the Ethiopian government sought alternative development finance to reduce its dependence on Western donors. Today, China is Ethiopia's largest trading partner. Specifically, the most significant finance from China is Exim Bank's finance in Ethiopian infrastructure.

Since the 2000s, the Ethiopian government has embarked on increased investment in structural transformation. The Ethiopian government planned major infrastructure projects to facilitate its industrial-driven growth development strategy. Chinese agencies – including the Chinese Exim Bank - both build and finance many of these infrastructure projects. Signature projects include the US$ 4 billion 750 km Addis Ababa - Djibouti Standard Gauge Railway and the US$ 475 million Light Rail Transit in Addis Ababa. Agreement for these loans and credits are negotiated at project levels.

In theory, recipient governments apply for loans from the Exim Bank of China. In reality, however, because state-owned enterprise (SOE) contractors' have profit-seeking priorities and strong networks within China, it is usually contractors who secure national-level infrastructure construction projects that initiate the negotiation process. In reviewing the feasibility of the proposed project, the Exim Bank compiles a feasibility study of the project. But it is important to note that the Exim Bank relies heavily on the information provided by the contractors to execute their feasibility study.

For the contractors, access to national financial support is a significant advantage in their competition with global contractors. Exim Bank finance is primarily used to support Chinese exports. However, Exim Bank finance is also arguably developmental because it contributes to essential infrastructure projects, which facilitate structural transformation in Ethiopia. Besides, the Exim Bank's finance model borrows heavily from China's domestic development experience, where investment in infrastructure was deemed developmental by nature.

China's Exim Bank was established in the middle of the 1990s when a series of political and economic reforms in China gradually resulted in a land-centered, investment-led development model, in which the government invests heavily in infrastructure to boost industrial and real-estate development. Finance from the policy banks was a key element in this growth model, and the experience in China has informed the bank's overseas investment practices after the 2000s. Exim Bank-financed projects, including the Addis-Djibouti Railway and Addis Ababa LRT, are considered key infrastructure projects to facilitate a modernized, industrialized country and were initiated and planned by the Ethiopian government with the help of international expertise.

Because the loans are negotiated at the project level, and the terms are somewhat opaque, there is evidence that borrowing governments do have some leverage. For example, after the new Prime Minister Abiy Ahmed took power in 2018, he managed to restructure the loan for the Addis-Djibouti Railway and extended the maturity period by 20 years.

THE INDIAN EXIM BANK'S LINES OF CREDIT

THE INDIAN EXIM BANK'S EXPERIENCES in Ethiopia have evolved closely in line with the Ethiopian government's strategic engagements with India. India's diplomatic relationship with Ethiopia has been a relative outlier within East Africa, largely based on diplomacy and South-South friendship rather than being closely associated with a large diaspora, as in the rest of East Africa. Since the 2000s, Ethiopia has been a strategic partner within Africa, accessing Exim Bank loans and hosting Indian government delegations on several occasions. Indian Exim Bank and private sector investments have closely followed Ethiopian government demands. Initially, Indian investments did not yield expected results, with lagging outcomes in sugar investments and land grabs accusations in private agricultural investments. Newer Exim Bank investments – driven by Indian private investors and the Ethiopian government – have now begun to target India's manufacturing sector. Along with other funding for construction and engineering, these projects have contributed to improving Ethiopia's diplomatic relationship and delivering key development benefits in line with Ethiopia's government strategy.

Formally, Indian Exim Bank funding remains demand-led, with recipient governments responsible for approaching the Indian government to seek a loan. The recipient government then contracts an Indian firm as part of public procurement for projects. Initially, most firms employed in these projects were SOEs working in the construction, engineering, and infrastructure sectors. Gradually, there has been an increasing incidence of private sector actors employed on Exim Bank-financed projects. This is in line with the evolution of India's broader domestic political economy, where private sector firms have become increasingly influential while SOEs power has waned (or has even being privatized). The Ethiopia example highlights two cases where Indian private firms accessed Exim Bank funding directly. The two firms were in Ethiopia's manufacturing sector and were already key investors in the apparel sector (Arvind and Kanoria).

Indian Exim-Bank-funded investments in manufacturing remain rare in African countries. However, such goals benefit the Indian Exim Bank in two ways. First, it supports goals of internationalizing investments of Indian firms (which is one of the Indian Exim Bank's central goals). Second, Exim Bank's investments in Ethiopia show the importance of working with governments, which have a clear strategic plan for investments. Through working closely in line with the Ethiopian government's strategic goals, these investments have been beneficial for Indian companies (in addition to these companies already being large household names in India). Too often, Indian Exim Bank investments have been guilty of supporting unqualified companies hoping to embark on an adventure in African countries.

If recipient governments can identify strategic sectors for investments, the Exim Bank should be more active in creating opportunities for partnerships with domestic firms. This would ensure less negative outcomes and publicity, as well as a more productive use of Exim Bank financing facilities.

CHALLENGES AND PROSPECTS

MUCH CAN BE LEARNED FROM Ethiopia's strategic engagement with emerging donors in using Exim Bank loans to fund development objectives. In most countries, dependence on specific donors (whether traditional or rising) has often shaped how governments engage with funders. As the pandemic rages on, new opportunities may arise to reconfigure how governments invest in structural transformation. Financing from Exim Banks should be used to support those objectives strategically.

Of course, the current models of Chinese and Indian Exim Banks loans are not without challenges. In the Chinese Exim Bank finance model, the project evaluation and monitoring system within the Exim Bank are relatively weak. Project research relies too much on the engineering aspects of the project and neglects the long-term financial sustainability of the project. Although capacity building in the local government is also easily overlooked in the model, capacity building has proved to be substantial in facilitating the developmental purpose of these infrastructure projects.

The Indian Exim Bank is plagued by regulatory challenges. First, the limited power of the Exim Bank in relation to private firms (and closely-allied politicians and bureaucrats) means its financing remains vulnerable to being captured by the interests of speculative private firms. Second, within the Exim Bank there continues to be limited investment on research. Thus, Indian Exim Bank remains vulnerable to speculate private firms rather than being used strategically by the Indian government and its partner countries to invest in strategic and mutually beneficial developmental projects.

POLICY RECOMMENDATIONS

For the Chinese Exim Bank:

1. Develop a different feasibility study method for proposed infrastructure development projects, and focus on the financial and management model. Remodel the loan structure towards a more balanced risk distribution among institutions.

2. Integrate capacity transfer programs as part of infrastructure financing and planning.

For the Indian Exim Bank:

3. Identify how India's development partners can connect with prominent Indian firms to globalize their activities in strategic investments that can support economic transformation.

4. Ensure that Indian private firms do not take advantage of the increased access provided by them through the new loan arrangements.

For the Ethiopian government and other recipient governments:

5. Continue to manage donors to ensure specific market-led agendas are not allowed to overpower development priorities.

6. Establish research teams (as they did in the Ethiopian Investment Commission) to identify companies and funding mechanisms that may be best suited to achieve desired development objectives. ★

AUTHORS

ZHENGLI HUANG is a Post-Doc Researcher in urban and rural planning at Tongji University, Shanghai. Her work focuses on China's development finance and its impact on African urbanization, especially on housing, urban policy, and governance.

PRITISH BEHURIA is a lecturer in politics, governance, and development at The University of Manchester's Global Development Institute. His research examines the political economy of transformation under 21st century globalization.

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SAIS China-Africa Research Initiative
1717 Massachusetts Ave NW, Suite 733
Washington, DC 20036
www.sais-cari.org
Email: sais-cari@jhu.edu

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