UNIVERSITY OF NAIROBI

INSTITUTE OF DIPLOMACY AND INTERNATIONAL STUDIES

CHINESE FOREIGN DIRECT INVESTMENTS IN KENYA’S ECONOMY,
(2000-2010)

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REG. NO: R50/75165/2009

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A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE AWARD OF MASTER OF ARTS DEGREE IN
INTERNATIONAL STUDIES.

2011
DECLARATION

This research project is my original work and has not been presented for a degree in any other university.

Signature: ........................................ Date: 8th November 2011
Wilson Ronoh

This research project has been submitted for examination with my approval as a university supervisor.

Signature: ........................................ Date: 8th November 2011
Dr. Anita Kiamba
DEDICATION

I dedicate this study to my wife Sharon for her continued support and to my daughters Joy and Caren for whom my studies will hopefully spur them to higher aspirations.
I am indebted to several people for their invaluable contributions to the completion of this research project and course. My utmost gratitude goes to my supervisor Dr. Anita Kiamba for her patience and guidance. My sincere gratitude also goes to Lt Colonel Pius Migue at HQ KA and Lt. Colonel Nelson Kemboi at MoSD for enabling my studies. I also thank my housemates Major Ombachi and Major Gekara for their invaluable advice and support. I also pay tribute to Mr. Ngao of the Ministry of Finance, Mr. Ongudi of Ministry of Trade and Mr. Opiyo of the Ministry of Foreign Affairs for their assistance during my data collection. I also benefited most from my lecturers and classmates and thank them all profoundly.
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<td>ACP</td>
<td>-</td>
<td>African Caribbean and Pacific Countries</td>
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<td>AGOA</td>
<td>-</td>
<td>American Growth Opportunity Act</td>
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<td>BIT</td>
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<td>CDB</td>
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<td>EAC</td>
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<td>FDI</td>
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<td>FOCAC</td>
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<td>Forum for China-Africa Cooperation</td>
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<td>FPE</td>
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<td>GDP</td>
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<td>Gross Fixed Capital Formation</td>
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<td>GNP</td>
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<td>Gross National Product</td>
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<td>ICSID</td>
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<td>International Centre for Settlement of Investment Disputes</td>
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<td>IMF</td>
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<td>KIA</td>
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<td>LDC</td>
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<td>Less Developed Countries</td>
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<td>MIGA</td>
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<td>Multilateral Investment Guarantee Agency</td>
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<td>NIE</td>
<td>-</td>
<td>Newly Industrialized Economic</td>
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<td>ODA</td>
<td>-</td>
<td>Official Development Assistance</td>
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<td>OECD</td>
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<td>Organization to Economic Cooperation and Development</td>
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SAPs - Structural Adjustment Programmes
UK - United Kingdom
UNCTAD - United Nation Conference on Trade and Development
USA - United States of America
VAT - Value Added Tax
WTO - World Trade Organization
ABSTRACT
This Research Project contends that despite the criticism labeled against China’s increasing economic and political influence in Africa and particularly against the anticipated negative impact of its foreign direct investments in African countries, it is imprecise to condemn such investments as potentially harmful to an economy such as Kenya’s without subjecting them to empirical investigation. Consequently the study argues that although there are both gains and losses associated with Chinese Foreign Direct Investments, Kenya must continue to encourage investments from China because Kenya’s losses from these investments are the result of systemic weaknesses to absorb foreign investments in the Kenyan economy but these weaknesses can be addressed to ensure that the country’s economy benefits to the maximum from Chinese investments. Kenya needs to ensure that all foreign investments including Chinese create linkages with local producers so as to increase the possibility of technological and skills transfers. Kenya also requires to monitor and regulate the activities of those investments in Wholesale and Retail and Import and Export that compete unfairly with local businesses.

The main findings of this study are that Chinese Foreign Direct Investments in Kenya are driven primarily by the motive of seeking markets and secondarily by the motive of seeking resources. Chinese investments were found to benefit the economy of Kenya most through the injection of capital for infrastructural development and the creation of employment. The investments were however found to perform poorly in technological and skills transfers and the creation of important backward linkages with local producers. In essence the study established that Chinese investments in Kenya contribute considerably to Kenya’s economy and should be encouraged.
CHAPTER ONE

ECONOMIC GROWTH AND DEVELOPMENT

1.0 Introduction

Foreign Direct Investment, (FDI) refers to any form of investment that earns interest in enterprises which function outside of the domestic territory of the investor.\(^1\) The relationship between FDI and economic growth is a subject on which much has been written on. Most of the literature on the subject has its basis on neoclassical and endogenous growth theories.\(^2\) In these theories, FDI is explained as an important means to economic growth and development in that firstly, FDI augments domestic savings in the process of capital accumulation.\(^3\) Developing economies all have a major common problem of scarcity of capital necessary for financing development programmes. Due to this problem, a country can resort to borrowing from bilateral and multilateral donors, seek financial aid from the same donors or can create environments in which foreign investors can introduce new capital through their business ventures. Secondly, FDI is the main channel through which technology transfer takes place and the spillovers of these transfers lead to an increase in productivity and efficiency in the use of the factors of production.\(^4\) Thirdly, FDI leads to increases in exports as a result of increased capacity and competitiveness in domestic production. Other positive effects of FDI include the creation of employment and the transfer of managerial and entrepreneurial skills.\(^5\)

The success story of Singapore which three decades ago was a developing economy but due to progressive economic policies is currently classified as a Newly Industrialized Economy.

\(^4\) Ibid
\(^5\) Ibid
(NIE) is often cited as an example of the importance of FDI as a means for economic growth and development. Singapore recognized the connection between foreign investments and internationalization and chose to use FDI as its principal source of external capital and this strategy paid dividends in that the inflows of manufacturing FDIs helped turn the country into an industrialized economy. Other countries such as Taiwan and South Korea chose to use a FDI although on a controlled manner too have attained industrialization status. These countries were however able to use FDI to attain economic development because they had the ‘absorptive capacity’ for FDI in the form of a high level of human capital development and a high degree of economic and trade openness. The presumption is always that such economic growth successes can be replicated in developing countries such as Kenya where the pursuit of industrialization status has not been realized if these countries developed the requisite capacity and environments to absorb FDI and if they received constantly high volumes of FDIs.

The Kenya Vision 2030, which covers the period 2008 to 2030, is the government’s current blueprint towards transforming the country into a newly industrialized middle-income country by the year 2030. To achieve the objectives of the strategy, the government plans to attract more foreign capital and manufacturing technology through FDI. Kenya’s renewed plans for industrialization has coincided with China’s massive economic growth that has necessitated it to increase economic cooperation with African countries for resources, markets and other strategic considerations. China is therefore becoming an important source of development aid and investments and trade for Kenya and many other countries in the continent. However, an international discourse of China growing economic influence in Africa has emerged in Western

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6 Ball D A et al, *International Business- The Challenge of Global Competition* op. cit., p. 231
7 Ibid
8 Ibid
countries particularly the United States of America, the United Kingdom and France that traditionally have political and economic links with Africa.\textsuperscript{10} The tone of the discourse is negative and skewed with China portrayed as a rival for resources and influence in the continent. The motives for its increased economic and political cooperation with many African countries have become a major source of speculations and discourses. On one hand, such countries as Kenya welcome China’s readiness to assist in development programs and investments as a means towards economic growth and development. On the other hand, sentiments originating particularly from Western Europe and America insinuate that developing countries in Africa do not understand China’s motives for its increased economic cooperation with Africa and that the likely outcomes of such cooperation are economic losses for African economies. Against this background, this study sought to answer questions as to how Chinese FDI inflows to Kenya are influencing the country’s overall economic growth and development strategy.

1.1 Background to the Research Problem

Africa is the second largest continent in the world with a population of about 1 billion people.\textsuperscript{11} Holding other factors such as massive poverty levels in the continent constant, this population together with the added attractiveness of Africa as a rich resource base, creates a great potential for Africa to be a prime destination for foreign investments and resulting in better economic outlook. However, as it is now, Africa in comparison with other continents is the poorest economically with 33 countries in the continent included in the list of 49 world’s Less

\textsuperscript{10} Davies M, ‘How China is Influencing Africa’s Development’ \textit{OECD Development Centre-Perspectives on Global Development 2010 (Pretoria, 2010)} pp. 18-25

\textsuperscript{11} Ibid
Developed Countries (LDCs). According to United Nations Conference on Trade and Development (UNCTAD), global FDI flows in 2010 were estimated at US $ 1.122 trillion of which US $ 526.6 billion representing 47% went to developed economies in Europe, United States and Japan. Africa’s share of global FDI in the same year was estimated at a paltry US $ 50.1 billion representing only 4%. This disparity is clearer when one considers that FDI flows to such a small state as Singapore with a population of three million was US $ 37.4 billion during the same year. Of interest therefore would be why Africa attracts so little FDI.

The answer is that Africa and in particular sub-Saharan Africa has not been an attractive FDI destination. Most traditional investors from Western Europe and North America have been wary of Africa as a continent of conflicts, unstable regimes and economic disorder among other problems and hence not the best place to do business. In addition to this, many African states also perpetuate their unattractiveness as FDI destinations due to “poor political and economic structures.” For the last five decades, the continent’s general economic atmosphere has been gloomy with many countries in the continent experiencing indebtedness, stagnating economic growth and being ‘bottom-less pits’ of foreign aid that fail to translate into economic development. The traditional donors and investors in the West together with the International Monetary Fund and the World Bank sought to end this problem by enforcing the implementation of the Structural Adjustment Programmes (SAPs) of the 1980s and 1990s which were essentially tough policy measures in regards to democratization, governance, privatization, liberalization of

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13 UNCTAD, Global Investment Trends Monitor No 5 January 2011
14 Ibid
15 Ibid
16 Ball D A et al, International Business- The Challenge of Global Competition, op cit., p. 16
17 FDIs are said to be discouraged by fiscal regimes that do not promote export oriented activities, slow and arbitrary processes of setting up business and poor regulations in regard to management of labor relations and dispute resolution
the markets among other recommendations that most countries in the continent had to institute in order to continue receiving development aid and other forms of economic assistance\textsuperscript{18}.

Most of the affected countries were slow in implementing these programs and as result, Western aid, investments and other forms of support reduced or were withheld. Furthermore, recent global economic downturns have made both debt and equity financing difficult to secure and with Western private investors withholding or withdrawing capital from Africa as result of global financial problems and due to heightened risk aversion, Africa looked set to continue being the investment pariah of the planet.\textsuperscript{19} However, the success of China’s economic reforms and its emergence as a global economic power in the late 1990s changed the prospects of many African countries. China’s growing economy requires new sources of resources and markets and to achieve its strategies, started cooperating closely with African countries under the China-Africa model. This model assures many countries in the continent of trade, aid and investment opportunities that traditional Western development partners have reduced. Due to the less stringent requirements by China on African countries for economic cooperation and assistance, many African countries have increasingly sought to develop closer economic and even political cooperation with China. Apparently as evidenced in the various discourses, China’s rising economic and political portfolio in Africa has not been warmly received by the West.

This may not hard to understand because the United States of America on one hand and some European countries who had colonies in Africa, have been the major trade, development and investment partners of most of these countries. The steady increase in China’s investments and aid to countries across the continent making her the second largest investor in the continent after

\begin{footnotesize}
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19 & Davies M, ‘How China is Influencing Africa’s Development’ \textit{OECD Development Centre-Perspectives on Global Development 2010} op cit., p. 22
\end{tabular}
\end{footnotesize}
the United States creates serious competition for the West for Africa’s market, resources, investment opportunities and political alliances\textsuperscript{20}. Consequently, there is growing literature notably from the West that warn that any form of economic and political relationship with China have potentially malign consequences for the continent. However, most of these literature lack empirical evidence in their discussions of the possible negative impact of China’s economic activities in Africa and more so on a country-by-country basis. Consequently, studies in Africa particularly under the African Economic Research Consortium have been done with several Scoping studies on China’s economic relations with individual African countries and indeed there exists one on Kenya.\textsuperscript{21}. The study analyzed the extent of China’s Trade, FDI and foreign Aid in Kenya and recommends research on the impacts of the three economic activities on Kenya’s economy. The purpose of this study therefore was to assess the impact of Chinese FDI in Kenya between 2000 and 2010.

1.2 Statement of the Research Problem

What are the gains or losses resulting from Chinese FDI in the economic growth of Kenya? A scrutiny of the criticism of Chinese economic cooperation with African countries reveals two broad categories of thought. On one extreme there is a growing literature based on a hyped up Chinese peril in Africa. Advocates of this line of thought make sweepingly alarmist and possibly exaggerated predictions on the long term impact of China’s trade, investment and development initiatives in Africa. The opponents of an increasingly strong Chinese influence in Africa warn that China- Africa relations are unequal and exploitative and that African countries are most likely to lose while China gains. Africa is depicted as entering willingly into a phase of Chinese


neo-colonialism five decades after emerging from Western colonialism. On the other hand are scholars who do not see China-Africa relations on such an alarmingly speculative manner but treat China’s economic activities in Africa as a healthy South-South trade and investment relationships spurred by the forces of globalization and which has the potential to increase economic and political competition in Africa that would result in an overall welfare gain for African states.

There are a large number of Chinese investors who have set up business activities in Kenya that include infrastructural development, wholesale and retail, manufacturing, import and export, motor vehicle and motorcycle assembly, hospitality among other businesses. Whereas Kenya requires and makes efforts to attract such investments, their actual impact on the economy has not been assessed. This study sought to find out the impact of each form of Chinese investments in regards to the generally known benefits of FDI. Do these investments offer benefits that assist Kenya to attain its economic development goals or are they mainly serving the economic interests of China and therefore validating the earlier stated sentiments against China’s economic influence in Africa?

1.3 Research Questions

i. What constitutes Chinese Foreign Direct Investment are in Kenya?

ii. How are the investments contributing to the growth of Kenya’s economy?

iii. Should Kenya encourage more Chinese investments?
1.4 Objectives of the Study

The general objective of the study was to examine the impacts of Chinese direct investments in Kenya between 2000 and 2010. The specific objectives of the study were:

   i. To identify the nature of Chinese FDIs in Kenya
      
   ii. To identify the effects of Chinese investments in the country.

   iii. To examine the implications of the effects of Chinese FDIs on Kenya-China economic relations.

1.5 Hypotheses

   i. Chinese FDIs in Kenya are beneficial in Kenya’s economy and should be encouraged.
      
   ii. The sentiments on anticipated negative impacts of Chinese FDIs should be ignored because they are.

1.6 Literature Review

This section reviews literature on the relationship between FDI and economic growth. Theories of economic growth are also reviewed with an emphasis on how FDI can lead to the growth of an economy. The economic growth of an economy is defined by Kuznets as;

   “A long term rise in capacity to supply increasingly diverse economic goods to its population with this growing capacity based on advancing technology and the institutional and ideological adjustments that it demands”\(^{22}\).

Growth is also defined as a real increase in a country’s total output or Gross Domestic Product (GDP). The determinants of this growth are said to include first, growth in labour force such as

\(^{22}\) Todaro M.P., *Economics for a Developing World*, op cit., p. 116
occurs when population grows or participation rates rise. Secondly, growth is determined by investment in human capital through education and training. Thirdly, it is determined by investments in physical capital such as factories, machinery, and transportation and communication facilities and finally through technological change brought about by innovation that introduces new ways of producing existing products and new forms of business. There are differing views among economists on exactly how to promote economic development which in addition to the increased GDP, also includes fundamental changes to the structure of the economy characterized by growth in industrial capacity, a decline in agriculture’s share of GDP as well as significant changes in population growth, rural to urban migration and employment opportunities. There is consensus however that economic development cannot be realized without economic growth.

1.6.2 The relationship between Foreign Direct Investments and economic growth

The relationship between FDI and economic growth is a widely covered subject in the development economics literature. In recent years, efforts to understand the determinants of economic growth and the considerable research on externally-led growth led by endogenous growth theories has made it more possible to include FDI as one of the determinants of long-run economic growth. The interest in the subject has also grown out of the substantial increase in global FDI flows that started in the late 1990's, and led to increased research on its determinants. A review of the theories of economic growth reveals differing points of view regarding the determinants of economic growth and in particular the role of FDI in this growth. In the context of either neo-classical or endogenous growth models, the effects of FDI on the economic growth

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of the receiving country differ. Even with the inclusion of FDI in the model of economic growth, traditional growth theories such as the Harrod-Domar and Neoclassical theories confine the possible impact of FDI to the short-run level of income. According to the neo-classical models, FDI can only affect growth in the short-run because of diminishing returns of capital in the long-run. These growth theories postulate that long-run growth can only happen from the both exogenous labor force growth and technological progress. However, the rise of endogenous growth models made it possible to model FDI as promoting economic growth even in the long-run through the permanent knowledge transfer that accompanies FDI.26 As an external factor, this knowledge transfer, with other factors emanating from outside the economy will account for the non-diminishing returns that result in long run growth. Hence, if growth determinants, including FDI, are made endogenous in the model, long run effects of FDI will follow. Therefore, a particular channel whereby technology spills over from advanced to poor countries is the flow of FDI.27

1.6.3 Harrod-Domar growth theory

The arguments in favour of FDIs to spur economic growth in a country grew largely out of the traditional neoclassical analysis of the determinants of economic growth.28 FDI as well as foreign aid are seen as ways of filling in gaps between domestically available supplies of savings, foreign exchange, government revenue and management skills and the desired level of these resources necessary to achieve economic growth and development targets. The Harrod-Domar growth theory developed in the 1940s by economists Roy Harrod and Evsey Domar postulates a direct relationship between a country’s rate of savings denoted as $s$, and its growth output

26 Ibid pp 389-403
denoted as \( g \), in the equation \( g = \frac{s}{k} \) where \( k \) represents the national capital-output ratio.\(^{29}\) Using this model, if for example in a given country the targeted annual Gross National Product (GNP) growth rate is 6 per cent, with the capital output ratio at 4 then the needed rate of annual saving is \( s = 6 \times 4 \) is 24 per cent. If the saving that can be mobilized domestically is for example 15 per cent of GNP, then a 'savings gap' of 9 per cent exists and if this gap can be filled by FDI the growth rates can be attained.\(^{30}\) This model is simple with relatively small data requirements. However, this model assumes that the economy enjoys full employment of both labour force and capital stock and given that this in reality is not true of any economy, it may not be useful in this study due to its likelihood of resulting in inaccurate long-run economic predictions.

1.6.4 Neoclassical economic growth theory

This theory of growth was introduced by Robert Solow in the 1950s. The theory postulates that a sustained increase in capital investment increases economic growth only temporarily because the ratio of capital to labour goes up.\(^{31}\) This is to say that FDI therefore can only affect growth in the short-run because of diminishing returns of capital in the long-run. The marginal product of additional units of capital is assumed to decline and thus an economy moves back to a long-term growth path with real GDP growing at the same rate as the growth of the workforce plus a factor to reflect improving productivity. A "steady-state growth path" is reached when output, capital and labour are all growing at the same rate, so output per worker and capital per worker are constant.

Solow believes that to raise an economy’s long-term rate of growth requires an increase in labour supply plus a higher productivity of labour and capital. The model treats productivity

\(^{29}\) Ibid
\(^{30}\) Ibid
improvements as an 'exogenous variable' meaning that productivity improvements are assumed to be independent of the amount of capital investment. This model assumes that countries use their resources efficiently and that there are diminishing returns to capital and labor increases. From these two premises, the neoclassical model makes three important predictions. First, increasing capital relative to labor creates economic growth, since people can be more productive given more capital. Second, poor countries with less capital per person will grow faster because each investment in capital will produce a higher return than rich countries with ample capital. Third, because of diminishing returns to capital, economies will eventually reach a point at which any increase in capital will no longer create economic growth.

The modern understanding that technological innovation is central to the economic growth process has led to changes in economists' views on economic growth and hence a divergence from the ideas of the neoclassical theory. It is now largely accepted that technological change is largely endogenous to the economic system and that investments that increase the capital stock may in reality encounter increasing rather than diminishing returns as postulated by the neoclassical growth model.

1.6.5 Endogenous Economic Growth Theory

This model of growth was developed in the 1980s by Romer in an effort to more precisely define the attributes of economic growth. Romer and other endogenous growth economists believed that improvements in productivity can be linked to a faster pace of innovation and extra investment in human capital. Endogenous growth theorists stress the need for government and

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32 Ibid
private sector institutions and markets which nurture innovation, and provide incentives for individuals to be inventive. There is also a central role for knowledge as a determinant of economic growth. Endogenous growth theory predicts positive externalities and spill-over effects from development of a high valued-added knowledge economy which is able to develop and maintain a competitive advantage in growth industries in the global economy.

The main points of the endogenous growth theory are firstly, the rate of technological progress should not be taken as a given in a growth model – appropriate government policies can permanently raise a country’s growth rate particularly if they lead to a higher level of competition in markets and a higher rate of innovation. Secondly, there are potential increasing returns from higher levels of capital investment. Thirdly, private investment in Research and Development (R&D) is the central source of technical progress and that protection of property rights and patents can provide the incentive to engage in R&D. Lastly, investment in human capital through education and training of the workforce is an essential ingredient of growth.36

Other proponents of this model have brought in new ideas to model of endogenous growth but central to all their arguments is that the rate of technological progress is the main determinant of the long-term growth rate of income. Buckley argues that the extent to which FDI contributes to growth depends on the economic and social conditions in the recipient country37. He notes that countries with high rate of savings, open trade regimes and high technological levels would benefit from increased FDI flows to their economies. However, he warns that FDI may have negative effect on the growth prospects of the recipient economy if they result in a substantial reverse flows in the form of remittances of profits, and dividends if the multinational

corporations (MNCs) obtain substantial forms of concessions from the host country. Borensztein and De Gregorio argue that in order to benefit from long-term capital flows, the host country requires adequate human capital, sufficient infrastructure, economic stability and liberalized markets. They support the view that FDI fosters economic growth in the host country, provided that the host country is able to take advantage of its spillovers. Barro goes further to suggest that FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investment.

There is however conflicting evidence in the literature regarding the question as to how FDI relates to economic growth. Some studies suggest that FDI does not have an independent effect on economic growth and that its effect is dependent on the initial country conditions that allows it to exploit FDI spillovers. Trevino and Upadhyaya find that FDI is more likely to have a positive effect on economic growth in more open economies. Alfaro et al. argue that the growth enhancing effect of FDI is only possible in countries with developed financial systems. Such dependency theorists as Ajayi argue that dependence on foreign investment is expected to have a negative effect on economic growth and the distribution of income. Foreign investment creates an industrial structure in which monopoly is predominant leading to he refers to as an enclave economy in which local investors are excluded. As a result, countries that are wholly dependent on FDI will experience stagnation, unemployment and increasing inequality. This is

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consistent with Rhagavan's argument that FDI may have a negative effect on growth, particularly if the inflow of FDI leads to increased monopolization of local industries. Accordingly, the dependency theory predicts that FDI inflows may slow growth and produce greater levels of income inequality.

The UNCTAD World Investment Report of 2007 indicates the negative effect of FDI in Africa derives primarily from lack of competition and a distorted regulatory and incentive framework. Tandon argued that MNCs are in business to make profit and not for development and therefore FDI cannot be expected to result in tangible economic growth for a host economy but rather may result in outflows of resources in the form of profits and remittances by the MNCs. The theoretical discussion is therefore not conclusive as to the effect of FDI, however, what is clear is that FDI has both costs and benefits and that FDI is necessary but not a sufficient condition for economic growth.

There is a third category of literature that suggests that FDI exerts ambiguous effects on economic growth. DeMello on one hand discusses a two-way interaction of FDI and growth and argues that FDI may promote economic growth directly because it contributes to capital accumulation, and the transfer of new technologies to the recipient country. However he notes that FDI may not enhance economic growth if technology transfers do not augment the stock of knowledge in the recipient country through labor training and skill acquisition, new management
practices and organizational arrangements. Alfaro notes that although it may seem natural to argue that FDI can convey great advantages to host countries, the benefits of FDI vary greatly across the primary, manufacturing and service sectors. He posits that FDI exerts an ambiguous effect on economic growth with FDI in the primary sector tending to have negative effects on the economy while FDI in manufacturing have positive effects and FDI in the service sector having ambiguous effects. Lougani and Razin, Akinlo, Ayanwale, and De Mello, suggest either a non significant or a negative effect of FDI on economic growth depending on the rates of technological transfers and the ability of the host economy to absorb the new technology.

Equally, Habiyaremye and Ziesemer in a study of sub-Saharan African countries found that the overall level of capital investment does not seem to significantly affect economic growth because most of the capital was in the primary sector.

From the review of the theories and studies on FDI role in economic growth, two conclusions can be made. Firstly, FDI can contribute to economic development of host country in two main ways, augmentation of domestic capital and enhancement of efficiency through the transfer of new technology. By introducing new knowledge and investments in physical infrastructure like roads and factories, foreign investors may help to reduce what Romer referred to as “idea gaps” and “object gaps” between developed and developing countries. In addition, FDI can improve overall growth by promoting competition in the domestic input market and hence force local firms to become more productive by adopting more efficient methods. Secondly,

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51 Ajayi S ‘Accelerating Africa’s Development Five years into the Twenty-First Century’, *ADB/AERC International Conference* op cit. pp 23-38
FDI has both benefits and costs and its impact is determined by the country specific conditions in general and the policy environment in particular in terms of the ability to diversify, the level of absorption capacity, targeting of FDI and opportunities for linkages between FDI and domestic investment. Interestingly, while recognizing the importance of FDI to economic growth, economic growth itself has been identified frequently as an important determinant, among other determinants, of FDI inflow into a country. Rapid growth of an economy often attracts more FDI by multi-national companies (MNCs), as they locate new profit opportunities. This study will base its arguments on the endogenous growth theories and will particularly hope to improve on the studies of such proponents of the theory as DeMello and Alfaro who suggest that FDI has both benefits and costs to an economy.

1.7.0 Justification of the Research

Much attention has been given to China’s economic activities in Africa especially in the last one decade. China is today a major trading, investment and development partner for many African countries. China presents its policies as opposites of the West’s and this is the basis for the West’s criticism of China-Africa relations. There is a lot of literature notably from the West that warn of Chinese neocolonialism, exploitation of resources, entrenching of corruption and poor governance in the continent, killing of Africa’s industrialization efforts with cheap and poor quality imports among other ominous warnings. However two issues can be discerned from these literatures. First, most can out rightly be written off as unscholarly due to their racist and virulent nature. Secondly, most of them while warning of negative impacts of Chinese investments and other economic activities are not based on empirical evidence. They dwell on generalizations and

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speculations of the perceived negative impacts of Chinese activities and as such the impact of Chinese FDIs particularly on a country-by-country basis has not been fully analyzed.

The period 2000-2010 represents the period during which China-Kenya economic relations strengthened and grew and also coincides with China’s rapid economic growth that saw the rise in her global economic and political profile. The Scoping Study on China-Africa Economic Relations –The Case of Kenya (Onjala, 2008) is a comprehensive effort to analyze the extent of China’s trade, investment and aid in Kenya. The scholar notes that the overall impacts of China’s economic relations with Kenya are mixed and points out that given the implications of such impacts for political and social change, this is an area for further research. This study sought to analyze the impact of the increasing number of Chinese FDIs in the recent past on Kenya’s economy and hopes to contribute to the enrichment of the existing body of knowledge on China’s economic relations with Kenya.

1.8.0 Theoretical Framework

This study adopts the endogenous economic growth theory in its attempt to address the various dimensions of the problem under investigation. The basis of this theory is that technological change is an economic good and is the driving force of economic growth and this change arises due to people responding to market incentives and that it is inherently different from other economic goods. Technology under this theory is taken as a good that is neither a conventional nor a public good but instead is a non-rival partially excludable good. The distinction between a rival and non-rival goods and the degree to which their use can be excluded from others is the

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key premise of the endogenous model. A rival good is one that can be possessed by only one person at a time whereas a non-rival good can be used unlimitedly by more than one person or firm. Technology is considered a non-rival input that is partially excludable in that there is no free access to it.

This theory was developed by Romer who argued that economic growth begins with improvements in productivity which results from technological innovation and increased investment in human capital. Other proponents of the theory include Wang, Walz and Findlay. Wang posits that FDI facilitates technological diffusion which in turn narrows the income gap among the population through human capital development and hence decreases poverty levels which is an indicator of economic growth. Walz suggests that the indirect transfer of technology through FDI stimulates active Research and Development and therefore predicts that policies promoting FDI will lead to faster economic growth. Findlay demonstrated that technological progress in a developing economy increases with the opening up to FDI and that foreign investments helps in increasing the rate of technical progress in the host country through a ‘contagion effect’ from the more advanced technology and the adoption of management practices used by the foreign firms.

The endogenous theory is considered appropriate in analyzing the impact of Chinese FDI in Kenya in that Kenya’s objective in encouraging FDI from different sources including China is to primarily foster the country’s industrialization efforts as a means to attaining the Kenya Vision 2030 development objectives. This study will thus adopt this theory in analyzing the extent to which Chinese FDIs in Kenya are assisting the country’s industrialization efforts through

introduction of innovative and modern technology, stimulating active Research and Development, improvement of human capital and creating backward linkages that allows the transfer of appropriate technology and management practices that can improve the productivity of local producers and businesses.

The issues expected to arise from using this theory will be drawing conclusions on whether the Chinese FDIs that do not involve direct technological transfers or which do not create linkages with local industries and producers can be generalized as impacting negatively on the Kenyan economy. The endogenous growth theory is a Western originated growth model that may not be appropriately gauge the effectiveness of Chinese FDIs in a country like Kenya which primarily aims to attract any form of investments the lack of technological transfers and linkages notwithstanding.

1.9 Methodology of the Research

This section details how data collection and analysis is done during the research study. This includes determining the research design, the type and sources of data, research population, sampling design, data collection and data collection instruments that will be used in the study.

Primary and secondary data was essentially used in this research study. This was made up of first hand data collected directly from respondents by the researcher. The respondents included Government officials in the Ministry of Finance, relevant departments of the Trade and Industry and Foreign Affairs Ministries. These Ministries are directly or indirectly involved in promoting foreign investments in the country. Other respondents were identified in the Kenya Investment Authority the government agency directly involved in assisting interested investors to establish businesses in the country and collating relevant data on their activities. The Kenya Export Promotion Council was also identified as a source of information given its role in promoting
Kenya's exports to such destinations as China. Foreign businesses in the Export Promotion Zone, local businesspeople and the corporate sector were also identified as useful sources of information given the proliferation of Chinese investments, technology and consumer products in Kenya. This study will adopt descriptive research design. This is because the study will be seeking to describe the effects of Chinese FDI in Kenya. Both structured and unstructured questionnaires were administered to a total of 100 respondents. This non-verbal means of data collection was thought appropriate so as to reach a wider population as it is less time consuming and causes less disruptions to the respondents' schedules.

The researcher collected the primary data collection instruments from the respondents and ensured that they were duly completed. Only questionnaires with 80% of the questions filled were included in the data analysis. Both the primary and secondary data were collected, classified, coded and analyzed. Primary data was analyzed quantitatively. This was done using summary tables. Qualitative data analysis was carried out on secondary data from reports, journals, electronic library and other sources.

1.9.1 Scope and Limitations

The purpose of this study was to assess the impacts of Chinese FDI in Kenya between 2000 and 2010. The study therefore confined itself to this period. The country has witnessed substantial investments from China that includes among roads constructions, oil pipeline construction, a battery manufacturing factory, motor vehicle sales outlets, motor cycle assembly and sales outlets, restaurants, agricultural machinery sales outlets and a proliferation of Chinese products traded in by retailers. These investments may however be more than identified by the study since
some may have been established before the study period and the impacts may thus be far reaching than the study could establish.

1.9.2 Chapter Outline

Chapter One- Economic Growth and Development

This chapter provides an insight into the structure of the study. It lays the background in which the introduction, statement of the problem, objectives, hypotheses, justification, literature review, theoretical framework, research methodology and chapter outline are discussed.

Chapter Two –The role of Foreign Direct Investments in economic growth

This chapter examines the relationship between FDI and economic growth by looking at the theoretical underpinnings of the subject.

Chapter Three – Foreign Direct Investments in Kenya

This chapter examines the role that FDI has played in Kenya’s economy since independence. Against this background the trends, types and volume of Chinese FDI in Kenya over the research period are discussed

Chapter Four: An Analysis of Chinese Foreign Direct Investments in Kenya.

This Chapter analyzes the forms and volumes of Chinese FDI in Kenya and through the collection and analysis of relevant data assesses their impacts on the economy.

Chapter Five: Conclusions and Recommendations

Drawing from the findings of the study, this chapter offers a conclusion and recommendations concerning the future of Chinese FDIs in Kenya.
CHAPTER TWO

THE ROLE OF FOREIGN DIRECT INVESTMENTS IN ECONOMIC GROWTH

2.0 Introduction

Foreign investments are essentially divided into two components, Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). FDI as discussed in this study is the type in which the investors participate in the management of the firm in addition to earning returns in the form of profits and dividends from their investments while FPI on the other hand is the purchase of stocks and bonds solely for the purpose of obtaining a return on the funds invested.\(^1\) The distinction between the two components is however sometimes unclear especially in today’s globalizing world in which there are many international mergers, acquisitions and alliances. For example, investments by a foreign investor in the stock of a domestic firm are generally considered a direct investment when the investor’s participation ratio is 10 percent or more. In contrast, deals that do not result in the foreign investor obtaining at least 10 percent of the shareholding are classified as portfolio investments.\(^2\)

The distinction between direct and portfolio investments becomes more unclear when current global business practices are considered. Companies increasingly form strategic relationships with firms from other nations in order to pool manufacturing, marketing and technological resources while keeping their equity participation below 10 percent. Financing from foreign investors can therefore be treated as portfolio investment even when these investors are actively involved in the concerned unlisted company’s operations with the objective of ultimately being major shareholders when the company goes public. The effects of globalization have therefore

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\(^2\) Ibid
caused deep economic interconnections and interdependence and over the last two decades, foreign direct investment flows have grown rapidly all over the world. Foreign investments and trade are increasingly being regarded as the main drivers of economic prosperity and all countries and in particular the developing countries seek more foreign investments as an important element in their strategy for economic development. In light of the expected benefits, theories such as neoclassical and endogenous theories exist to show the positive relationship between FDI and economic growth. While these theories and other studies show that FDI has significant positive effect on economic growth, others such as the dependency theory give evidence to the contrary. The studies generally suggest that the effect of FDI on economic growth depends on whether a country has the absorptive capacity in terms of an educated workforce, institutional infrastructure and liberalized markets that allow it to exploit the positive effects of FDI. A country that lacks this absorptive capacity will in addition to not attracting high levels of FDI, not be able translate the effects of FDI into tangible economic growth.

This Chapter analyzes current global trends of FDI, the theoretical bases for international investment and the theoretical relationship between FDI and economic growth.

2.1 Current Global Trade and Investment trends

In order to understand why the developed countries of the world take up the bulk of global FDI flows, it is important to look at global trade flows because trade complements and has a causative effect on investments. Countries that trade more with each other are most likely to

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investment more with each other. The volume of international trade in goods and services measured in dollar value has been rising and in 2010 stood at US $ 18.6 trillion in comparison to US$ 4 trillion and US$ 11 trillion in 1990 and 2000 respectively.\textsuperscript{6} The dollar value of total world exports in 2010 were greater than the Gross National Products (GNPs) of every nation in the world and recently surpassed even that of the United States of America which at an estimated US$15 trillion is the highest in the world.\textsuperscript{7} This growth in trade has however been uneven. The European Union (EU), North America and East Asia have been the major beneficiaries of the increased growth in global merchandise and services trade. Whereas Africa’s level of exports has also been rising, the continent’s share of overall global exports of goods and services was the smallest in 2010 at US $ 630 billion.\textsuperscript{8}

On the other hand global FDI inflows in 2010 were estimated at US$ 1,122 billion with developed economies of Europe, North America and Japan taking up FDI valued at US$ 526.6 billion which is equivalent to 47 percent of global FDI flows.\textsuperscript{9} Africa, Latin America and Caribbean, Asia and Oceania and South, East and South-East Asia shared the remaining 53 percent but out of this, Africa’s share of global FDI in 2010 was valued at US $ 50.1 billion or only 4.5 percent.\textsuperscript{10} These figures serve to emphasize the fact that developing countries trade and invest more with one another. Given the causative role of the two economic activities on national incomes and economic prosperity in general, it is understandable why the regions of the world that take up the bulk of the world’s trade and investments continue to register high GNPs and general economic wellbeing while regions such as Africa whose portion of world

\textsuperscript{6} UNCTAD, World Trade Report: Promoting Linkages, United Nations, New York 2010
\textsuperscript{7} Ibid
\textsuperscript{8} Ibid
\textsuperscript{9} UNCTAD, Global Investment Trends Monitor No 5, United Nations New York January 2011
\textsuperscript{10} Ibid
trade and investments is small are generally underdeveloped economically.

There are several reasons why Africa and sub-Saharan Africa in particular cannot compete favorably as an FDI destination with other regions of the world. Many countries in Africa are known to suffer from inadequacies of their regulatory and administrative practices with respect to the treatment of foreign investors and the protection of their investments which greatly diminishes the attractiveness of these nations for receiving incoming FDI. This is said to combine with other social, economic and political factors that make Africa unattractive as an investment destination. Due to current economic trends and upon recommendations by international financial institutions and donor countries many African countries have introduced FDI liberalizing legislations but these have not ensured massive investment flows to Africa.

To better understand why an increased FDI inflow is the desire of all developing economies, it is important to also look at the theories of international investments. These theories explain why investors would choose to invest in other countries and may explain why some countries are better destinations of FDIs than others. Based on this, the relationships between FDI and economic growth can further be explored.

2.2 Theories on International Investment

Classical economists such as Maynard Keynes postulated that differences in interest rates for investments of equal risk were the reason why international capital moved from one nation to another. For this to happen there had to be perfect competition. Such contemporary economists as Kindelberger however state that under perfect competition FDI would not occur nor would it

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be likely to occur in a world wherein the conditions were even approximately competitive. FDI involves the establishment of production or other facilities abroad either through the establishment of new facilities from the ground up or the purchase of an existing business in another nation. It is usually assumed that strategic motives will be the driving force for decisions to invest abroad, driven by the desire to find new markets, access raw materials, achieve production efficiencies, gain access to new technologies or managerial expertise, enhance political safety of the firms’ operations or respond to competitive or other pressures in the external environment. Some of the theories that explain international investment include:

2.2.1 Monopolistic Advantage Theory

This theory developed by Stephen Hymer in the 1960s demonstrated that FDI occurs largely in oligopolistic industries rather than in industries operating under near-perfect competition. This means that firms in these industries must possess advantages not available to local firms in order to overcome liabilities such as language, differences in culture, laws and regulations, increased costs of operating at a distance and increased costs of operations that cause a foreign company to be at a disadvantage against local firms. Hymer reasoned that the advantages must be economies of scale, superior technology, and superior knowledge in marketing, management or finance. These factors allow a foreign firm to operate more profitably than local firms.

14 Ibid
16 Ibid
2.2.2 International Product Life Cycle Theory

This theory explains that FDI is a natural stage in the life of a product. To avoid losing a market that it serves by exporting, a company is often forced to invest in overseas production facilities when other companies begin to offer similar products. This move overseas will be heightened as the firm strives to remain competitive first in its export markets and later in its home market by locating in countries where the factors of production are less expensive.

2.2.3 Follow the Leader Theory

This theory notes that when one firm, especially the leader in an oligopolistic industry enters a market, other firms in the industry follow. This theory is considered defensive because competitors invest to avoid losing the markets served by exports when the initial investor begins local production. They may also fear that the initiator will achieve some advantage of risk diversification that they will not have unless they also enter the market. They also usually suspect that the initiator may know something that they do not know and hence go in so as to be safe.

2.2.4 Eclectic Theory of International Production

This theory developed by Dunning attempts to provide an overall, framework as to why firms choose to engage in FDI rather than serve foreign markets through alternatives such as exporting, licensing, management contracts, joint ventures or strategic alliances. This theory

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maintains that for a firm to engage in FDI it must have the following three advantages; 

Ownership-specific: - This is the extent to which a firm can develop a specific advantage through the ownership of tangible and intangible assets not available to other firms and that this advantage can be transferred abroad. Owner-specific advantages include knowledge or technology, economies of scale, unique access to critical inputs or outputs.20

Location-specific: - A foreign market must have specific characteristics of an economic, social or political nature that will allow the firm to profitably locate to that market.21

Internationalization: - It is in a firm's best interest to exploit its ownership-specific advantages through internationalization in those situations where either the market does not exist or it functions inefficiently causing the transaction costs of using market-based options to be too high.22

The theories help to understand why firms choose to invest in other countries. However, they best serve to explain FDI flows in developed countries. Based on the global FDI flows discussed earlier, the major beneficiaries are developed countries. This is because there is a tendency for firms from developed countries to cross invest in each other's country. European firms tend to invest in America and vice versa because of the availability of vast markets for their products. This is evidenced by the number of American firms operating in Europe and similarly European firms operating in America.23 Japanese motor vehicle manufacturers set up subsidiaries in America and Europe ostensibly to follow their customers. The economic performance of the host country means that foreign firms setting base are assured of a market due to the high purchasing power of the citizens. This may explain why in Africa, South Africa being the best

20 Ibid
22 Ibid
23 Ibid
performing economy attracts the most FDI in Africa. Developed countries also attract massive FDI from other developed countries because they can learn best from each other. The Silicon Valley in the USA is the seat of high-end software technological inventions and attracts many investors who wish to learn from the domestic firms.\textsuperscript{24}

Although most European and American firms investing in Africa are guided basically by business considerations, there are political reasons that give advantages to firms from some countries over others. Due to economic ties with former colonial powers, most African countries tend to have more investments originating from these countries than elsewhere. French MNCs take up most of the investment opportunities in francophone countries in Africa, due to their economic and political ties with France.\textsuperscript{25} In former British colonies such as Kenya, Uganda and Tanzania, Britain is the biggest source of foreign investments. In such cases therefore, political considerations play a role alongside business motives in determining why MNCs operate in a particular country. Chinese FDIs to Africa although also guided by business motives are different in that they are government directed and sponsored. This is because most Chinese firms operating in Africa are state owned and enjoy access to capital from state-owned policy banks in particular China Export-Import Bank and China Development Bank.\textsuperscript{26} Those firms that are not state owned are provided with insurance so long as they operate in ways that are consistent with China's national interests. Chinese firms can therefore afford to invest heavily in African economies because of their government's support of their outward expansion through credit and insurance support and relaxation of rules restricting capital outflows.

\textsuperscript{24} Ibid pp47-49
2.3 Theories on Foreign Direct Investment and growth

Having discussed the reasons as to why foreign firms choose to invest in other countries it is possible to discuss the connection between these investments and economic growth. The Harrod–Domar, Neoclassical and Endogenous growth theories were developed between 1950s and 1980s in this order and it is the Endogenous theory which is more encompassing and expanded the determinants of growth by incorporating inputs that had not been considered by the first two. The dependency theory is also discussed here for its criticism of the impacts of multinational corporations on the economies of developing countries.

2.3.1 Harrod-Domar and Neoclassical growth theories

The theoretical rationale of the FDI flows and economic growth is based on the Harrod-Domar, neoclassical and endogenous growth also known as growth models in some books.27 The Harrod-Domar growth theory explained that capital formation raise the standards of living, which in turn results in higher growth. Harrod-Domar theory basically compares the natural growth rate and a warranted growth rate. It emphasizes that natural growth rate is a result of increase in labour force in the absence of technological change as compared to the warranted growth rate which depends on the savings and investment habits of household and firms. Harrod-Domar model was criticized by the neoclassical economist Robert Solow due to its assumption of fixed proportion of factors of production and substitutability between labor and capital.28

Solow argued that capital formation increases labour productivity in a dynamic process of investment growth.29 He accepts the assumptions of the Harrod-Domar model of long-run

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27 Todaro M.P., *Economics for a Developing World* op cit., p. 396
28 Ibid
growth without any fixed proportion. Solow considers an economy that combines capital and labour to produce a single homogenous commodity through savings, which are proportional to income and labour productivity. Knowledge has been considered as an important input in the production process in the neoclassical theory. According to this theory, with diminishing returns to physical capital and exogenous technological change, FDI cannot affect the long-run growth rate. Neoclassical theorists predict that countries with the same preferences and technology will converge to identical levels of income and growth rate subject to the absence of international capital mobility. Factor mobility enforces this prediction that capital always flows from capital abundant countries to where it is scarce. This leads to long run equilibrium with the equalization of capital-labour ratio and factor prices.

Neoclassical growth theory support FDI's positive contribution to the economic development of the host country and increase in the level of social well being. The reason behind this argument is that the foreign investors bring capital into the host country, thereby influencing the quality and quantity of capital formation in the host country. The inflow of capital and reinvestment of profits increases the total savings in the country. Government revenue increases via tax and other payments. Moreover, the infusion of foreign capital in the host country, generates employment, influences incomes distribution and generates foreign exchange, thereby easing balance payments constraints of the host country. Furthermore, infrastructure facilities would be built and upgraded by foreign investors. The facilities would be the general benefit of the economy.

30 ibid
31 Todaro M.P., Economics for a Developing World op cit pp 396-398
32 ibid
33 ibid
2.3.2 Endogenous Growth Theories

The endogenous growth theories that emerged in the mid 1980s expanded the role of capital to include knowledge as a central element of capital in addition to plant and equipment. Unlike the neoclassical growth theories, the new growth theories focused on the creation of technological knowledge and its transmission. Innovation and imitation efforts that respond to economic incentives are considered to be a major engine of growth. These theories therefore emphasize the role of Research and Development, human capital accumulation, and externalities. FDI is said to be the conduit to replace the inferior production technology in developing countries by a superior one from advanced industrialized countries through the transfer of technology, managerial and marketing skills, market information, organizational experience, and the training of workers.

Multinational Corporations according to endogenous growth theory, serve as the primary channel for the transfer of technology from developed to developing countries. However it is noted that the welfare gain of adopting new technologies for developing countries depends on the extent to which these innovations are diffused locally and that the cost of adoption of technology is affected by the availability of technical assistance and maintenance and the availability of complementary innovations, both technological and organizational. Due to scarce availability of these factors in developing countries, the cost of new technology remains high. Another advantage associated with FDI inflows according to the endogenous model is the rise in competition in an industry that is brought about by the entry of multinational players and which

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34 Todaro M.P., *Economics for a Developing World* op cit pp 396-400
37 Ibid
is likely to result in improvement in productivity. A rise in competition can lead to reallocation of resources to more productive activities, efficient utilization of capital and removal of poor management practices. FDI can also widen the market for host producers by linking the industry of host country more closely to the world markets which leads to even greater competition and opportunity to technology transfer.

The World Bank Guidelines on the Treatment of Foreign Direct Investment incorporates the endogenous theory when it recognizes: - .

"that a greater flow of direct investment brings substantial benefits to bear on the world economy and on the economies of the developing countries in particular, in terms of improving the long-term efficiency of the host country through greater competition, transfer of capital, technology and managerial skills and enhancement of market access and in terms of the expansion of international trade".

Proponents of the endogenous theory such as Kennedy have noted that host countries became more confident in abilities to gain greater economic benefits from FDI without resorting to nationalization as the administrative, technical and managerial capabilities of the host countries increase. The success of the NIEs is often used as model of other developing countries. The experience of these countries in particular Singapore, Taiwan, Hong Kong and South Korea shows that a mix of regulation and openness to FDI may become more beneficial to the host country. The same position is believed to be applicable to most of other developing countries.

Another proponent of endogenous growth theory, Wang, builds a dynamic two-country model to examine the interaction between growth and international capital movement. He links

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38 ibid
40 Kennedy C.R, Relations between Transnational Corporations and Governments of Host Countries: A look at the future; Transnational Corporations 1:1 pp 67-91
41 Wang J.Y & M Blomstrom, Foreign Investment and Technology Transfer: A Simple Model, European Economic Review 36 pp137-155
perfect capital mobility into two regions. According to him, human capital plays a crucial role in
determining the effective rate of return for physical capital which affects the direction and
magnitude of international capital movements. The model predicts that in the Less Developed
Countries (LDCs) the income gap is narrowed by an increase in the growth rate of human capital
and the technology diffusion rate. Wang also argued that FDI facilitates technological change,
and hence increases the rate of income growth.

Walz incorporates FDI into endogenous growth framework where MNCs play a critical role with
respect to growth and specialization patterns. He concluded that spillover effects of MNC’s
activities make innovations profitable. Furthermore, allowing for imitation in the LDC, the
indirect transfer of technology through FDI stimulates active R&D and growth. Therefore, he
predicts that policies promoting FDI will lead to faster economic growth.

Findlay constructed a model to examine the relationship between FDI and technological change
in a poor economy. The model assumed that the rate of technological diffusion from the
advanced to a backward country depends on two factors; Firstly, the rate of technological
progress in a backward regions is a function of technology gap between the advanced regions
therefore, the larger the technological gap between the foreign and the domestic firms the larger
the spillovers. Secondly, technological diffusion is similar to the spread of a contagious disease;
technology is most efficiently diffused when there is a personal contact between those having
knowledge of innovation and those who adopt it. These arguments have led to the hypothesis
that technological progress in a poor economy increases with the opening up to FDI. Findlay

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42 Walz U, Innovation, Foreign Direct Investment and Growth, Economica 64 pp. 63-79
43 Findlay R, Relative Backwardness, Direct Foreign Investment and the Transfer of Technology: A Simple
Dynamic Model, Quarterly Journal of Economics 92 pp 1-16
44 Ibid
further demonstrated that besides technology, saving propensity, tax rate of foreign profit and backward dependency on foreign capital are important factors that determine the transfer of technology from an advanced country to an underdeveloped region. He concluded that foreign investment helps in increasing the rate of technical progress in the host country through a “contagion effect” from the more advanced technology and the adoption of management practices used by the foreign firms.45

Das analyzed the transfer of technology from a parent firm to its subsidiary by utilizing the price-leadership model of oligopoly.46 He argued that domestic firms learn from MNCs and become more efficient. This increase in efficiency among domestic firms is assumed to be exogenous and costless. The rate of increase in efficiency is positively related to the activities of the MNCs’ subsidiaries. He concluded that MNCs benefit from the technology transfer from their parent company and the host country also benefits.

Models using endogenous growth theory framework thus primarily focus on the transfer of technology by MNCs from a developed parent country to subsidiaries in developing countries. Technology spillover is assumed to be proportional to the presence of FDI in the host country. The emphasis on the positive impact of FDI on growth suggest that FDI not only increases the domestic capital formation but also enhances economic growth by introducing new technologies, such as new production processes and techniques, managerial skills, ideas and new varieties of capital goods.47 However, based on the experiences and successes of the NIEs cited above, it is apparent that the technological diffusion expected to be derived from FDI inflows and which is

46 Das, S Externalities and Technology Transfer Through Multinational Corporations: A Theoretical Analysis, Journal of Development Studies 34 pp.31-34
in turn expected to lead to economic growth in LDCs, primarily depends on the absorptive capacities of these countries to adopt and implement new technologies. These capacities are in turn dependent on the quality of the workforce which is determined by the education and training system of the country concerned.

2.3.3 Dependency Theory

The impact of foreign capital and MNCs on host countries is examined by the Dependency theory. This theory primarily argue that the exploitation of the LDCs by Economically Developed Countries (EDCs) is exercised through indirect control by MNCs and is driven by the EDCs need for cheap primary resources, external markets, profitable investment opportunities and low-wage labor. The South or LDCs produces low-cost, low profit primary products such as agricultural products and raw materials. These help supply the EDCs production of high-priced, high profit manufactured goods some of which are sold to the LDCs. It is therefore in the interest of capitalist exploiters to keep LDCs dependent.

Dependency theory argues that foreign investment from developed countries is harmful to the long-term economic growth of developing nations. It asserts that First World nations became wealthy by extracting labour and other resources from the Third World Nations. It further argues that developing countries are inadequately compensated for their national resources and are thereby sentenced to conditions of continuing poverty. This kind of capitalism based on the global division of labour causes distortion, hinders growth, increases income inequality in

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48 This theory and the Modern World System theory are the second variants of Structuralism after the Marxist theory. Also referred to as neo-Marxist theories
50 Ibid
developing countries and therefore, LDCs must develop independently without depending on foreign capital, investments and goods.

The influence of the dependency theory peaked in the 1970’s; many authors advocated that dependency theory provided some useful qualitative methods to restrict FDI that brought in foreign capital. Various countries adopted dependency theory perspectives in the 1970’s, including some East Asian countries such as Indonesia and Malaysia. These countries adopted import substitution strategy and demonstrated a hostile attitude towards FDI which had harmful effects on their economies. During 1970s and 1980s however, Indonesia and Malaysia shifted their attention from dependency theory to more liberal policies to attract FDI. Throughout the world, globalization and the benefits of economic integration has shown that countries can no longer barricade their economies from external influence and it is upon each country to strategies on how to maximize their benefits from integration, trade and foreign investments.

2.4 Linkages between FDI and economic growth

Going by the theories discussed above, the role of FDI has been widely recognized as a growth enhancing factor in developing countries. There are a variety of channels through which FDI can promote growth in the host country with the most important being technology transfer and spillovers. Literature on economic growth has established the importance of technological progress in economic development. FDI often leads to technology transfer to affiliates of MNCs in the host countries. Spillovers occur through the interactions of multinational firms with domestic suppliers, customers, and worker mobility. Many developing countries rely primarily

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51 Hein S, ‘Trade Strategy and Dependency Hypothesis: Comparison of Policy, Foreign Direct Investment and Economic Growth in Latin America and East Asia’, Economic and Cultural Change 40:3 pp495-521
on FDI as a source of external finance because FDI stimulates economic growth more than other sources of capital inflows. Financial resources are largely used to expand productive capacity by increasing fixed investment in the host country while technological transfer and managerial know-how improves productive capacity. FDI also brings various networks such as sales and procurement networks to the host countries which can be used to expand business opportunities and at the same time increasing competitive pressures to the local businesses that may result in improvement of efficiency.

Developed countries and even NIEs whose economies are advanced have one thing in common—technological progress. Technology is evident in all sectors of their economies and this is used to the full advantage of the economy. Due to a technologically advanced agricultural sector, countries such as France with slightly smaller surface area as Kenya but with about double the population, is self-sufficient in food production and is in addition a major world food exporter. Israel's agricultural sector is also often cited as an example of how high-end technology has enabled Israeli farmers to turn deserts into highly productive farmlands that have made Israel a major world exporter of horticultural products. Switzerland is an example of how high-technology has enabled the country's manufacturing sector to catapult the country into advanced economy status. Switzerland is a small mountainous country without agricultural or mineral potential which imports low-value mineral raw materials and cocoa beans and with its high technology is the world's top exporter of high value watches, precision machinery,
pharmaceuticals and chocolates among other products. Technological advancement in Information Technology has also enabled such countries as India and Singapore to be major exporters of off-shoring services in the world today.

It has also been variously noted that FDI plays a crucial role and is likely to be the engine of host country’s economic growth because of capital formation and employment generation, promotion of exports, bringing in resources such as managerial skills, access to international production networks and established brands and finally FDI may result in technology transfers and spillover effects. The linkages that these contributions have with the economic growth of a country can be illustrated as in Figure 2.1 below. The diagram shows the direct and indirect impacts of FDI on economic growth. The injection of capital by a foreign firm through establishment of subsidiaries fills the resource gap between desired or targeted investment and locally mobilized savings. FDI also fills the gap between targeted foreign exchange needs and those derived from exports and as a result of government taxes also earns revenue to the host government. The advanced technology that FDI brings in, also impact directly on the economy. The indirect benefits of FDI are those that will accrue from exports generated by the affiliates of the foreign investors and the improved productivity effects to local firms as a result of imitation and competition.

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2.5 Conclusion

FDI is today widely perceived as an important source for fast-tracking industrial development in developing countries. Most developing countries including Kenya, have adopted proactive policies to attract FDI. This is because FDI is believed to be able to contribute to growth and

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57 Pradhan J, Foreign Direct Investment and Economic Growth in Developing Countries, Asian Economic Review 45.2 pp 197-217
development through injection of capital, introduction of new and beneficial technology, creation of employment opportunities and market access necessary for sustained development. Kenya provides ample incentives for foreign investment with policies and government agencies specifically meant to attract FDI. These have been accompanied by policies relating to privatization, deregulation of economic activities and greater reliance on market forces.

The results of the various studies reviewed above however points toward the following four prerequisites for such countries as Kenya that hopes to use FDI to spur economic growth; diversification, enhancing the absorptive capacity of local firms, providing opportunities for linkages between domestic and foreign investors and a targeted approach to FDI. This is to suggest that FDI’s growth enhancing effect is possible only when it stimulates domestic capacity of the host country’s citizens. The ability of government to promote policies that enhance the domestic capacity of its citizens suggest that government must target or aim at attracting specific types of FDI that are able to generate spillover effects in the overall economy. Here, the focus must be to employ promotional resources to attract a subset of FDI flows rather than FDI in general.

Literature attest to the fact that FDI has been more productive in Asia especially in Singapore, China, Taiwan, than other developing countries because of the targeted approach, which involved screening of investment applications and granting differential incentives to different firms and even prohibited some types of investment. The focus should be on quality FDI, the type of FDI that will significantly boost domestic competitiveness, enhance skills, and invariably leading to both social and economic gains.

One thing is clear at this point as regards FDI; to best realize the benefits of FDI, the development process must start from within a country, through a strong investment in human
capital accumulation and a significant increase in infrastructure provision so that a strong basis for a diversified production system can be established. This is the only means to ensure technological learning and technology diffusion from the targeted FDI.

The next Chapter will take this discussion further by examining the role that FDI has played in economy of Kenya since independence and will also closely examine China’s FDI in Kenya since 2000.
3.0 Introduction

The attainment of economic development is the aspiration of every underdeveloped nation. Economic development raises living standards and reduces poverty among the citizens of a country but can only be attained if consistent economic growth is achieved. As has been discussed in the previous chapters, the importance of FDI relates to its ability to spur the required economic growth in a country and put a country on a sustained economic development path. For FDI to result in tangible economic growth however, the inflows to a particular country should be in sufficient quantities and should appropriately directed to those sectors of the economy such as the industrial and services sectors that result in faster economic growth.

The connection between FDI and economic growth has been demonstrated from the theoretical discussions, to be its ability to bring in new capital resources, provide new technologies and enhance the efficiency of existing ones. Foreign investments are believed to have the ability to increase the rate of technological progress in the host country through a contagion effect from the more advanced technology and management practices used by foreign firms. This contagion effect results either through duplicating the technology used by the foreign firms or through accessing the latest technology. Such technology transfers may take place as a result of demonstration effects in which local firms adopt technologies introduced by foreign firms as a result of labour turnover whereby workers trained by foreign firms transfer

2 Ibid
3 Findlay R, Relative Backwardness, Direct Foreign Investment and the Transfer of Technology: A Simple Dynamic Model, Quarterly Journal of Economics 92 pp 1-16
technological knowledge to local firms or they start their own firms and apply the technology
that they have learned.

FDI also has the potential to create positive backward linkages. This is achieved through the
enhancement of the growth of domestic firms that may be engaged by the foreign investor to
supply raw materials or services, to distribute its products or any other function that
complements the productivity of the foreign and domestic firms and may lead to the
enhancement of skills and management techniques particularly of the domestic firms.4 Foreign
investors are an important source of manufacturing capability and this often strengthens the
export capabilities of the domestic economy through changing the export products of a country
from unprocessed primary products to value-added finished or semi-finished goods. Foreign
investors often also strengthen the trade ties between their country of origin and the host
economy and hence for a developing host economy, the enhancement of its exports results in
increased foreign exchange earnings and growth in the economy.

This does not however imply that FDI is the perfect answer to the economic problems of
developing economy.5 FDI has its disadvantages. Owing to tax concessions, investment
allowances, subsidies and tariff protections, the ease of repatriation of profits and dividends and
other incentives often provided to foreign companies by the host governments to attract FDI,
their contribution to public revenue via corporate taxes may be less than optimal. In addition, the
competition they bring into a market may stifle domestic savings and investment rates and may
adversely influence the development of indigenous entrepreneurship.6 Nonetheless, the attraction
of sufficient FDI inflows, their direction to relevant growth enhancing sectors of an economy and

4 Wang J.Y & M Blomstrom, Foreign Investment and Technology Transfer: A Simple Model, European Economic
Review 36 pp137-155
5 Borensztien E J, et al, 'How Does FDI Affect Economic Growth' J. International Economics. 45:1 op cit pp 130-
136
6 Ibid
their management depends on a government putting in place relevant policy frameworks that ensures that it has the absorptive capacity for FDI and be able to derive maximum from them.\textsuperscript{7} Due to the possible benefits of FDI, countries provide many incentives to attract them. Kenya has not been an exception and seeks to attract FDI through many incentives available for foreign investors. There are government Ministries and departments such as the Kenya Investment Authority whose mandates entail attracting foreign investments. However, due to the erratic and insufficient inflows, FDI has not resulted in the desired fast economic growth in Kenya.\textsuperscript{8} This chapter examines Kenya as a FDI destination and looks at the trends and inflows over the years, the types and origins of the FDIs and the contributions they have had on the economy. The chapter also examines the country’s investment framework in a bid to understand why Kenya has not attracted sufficient FDI.

3.1 An overview of Kenya’s economic performance

Although Kenya is the largest economy in East Africa, she has underperformed over the past two decades.\textsuperscript{9} The growth of the agricultural and industrial sectors under high tariff protection generated strong growth in the 1960s and 1970s. However, the oil crisis of 1979 and the slump in world coffee prices created serious pressures on the economy as the limitations of an agriculturally based economy prone to global price fluctuations and import - substitution policies became manifest.\textsuperscript{10} The 1980s and 1990s were in consequence difficult years for Kenya’s economy. There growth rates attained earlier fell and following the collapse of the East African

\textsuperscript{7} Todaro M.P., \textit{Economics for a Developing World}, op cit., pp. 392-397
\textsuperscript{9} Ibid
\textsuperscript{10} Ibid pp 123-124
Community in 1977, the regional market on which the country's industrial sector was heavily dependent was reduced. At the same time, the country was under massive political pressures from the donor community to reform its single party system and adopt multiparty democracy.11

Slow progress on these reforms led to reduction in donor budgetary and development support. Although the government relented and adopted multiparty democracy in 1992, reforms in other areas were slow and donor support did not resume immediately. Economically, therefore, the government had to contend with poor world prices for its agricultural exports, reduced donor support and the requirement to implement Structural Adjustment Programmes recommended by the World Bank and the International Monetary Fund (IMF). Furthermore, the macroeconomic and structural reforms that were instituted did not succeed in putting Kenya on a sustained high-growth path and in addition, the Government's attempts to control the deficit between revenues and expenditure, although relatively successful, failed to address the issue of current expenditure and succeeded only through a drastic reduction in capital spending. All these were accompanied by the deterioration of the once reasonably efficient and well-developed infrastructure and with increasing problems of governance and insecurity, private investment was discouraged. Despite some resurgence in growth in 1986-89 and 1995-96, real GDP growth rates were small and erratic as indicated in Figure 3.1 later in this discussion.12

The coalition government that took over in 2002 instituted broad governance and economic reforms that resulted in economic recovery and accelerated economic growth until 2007.13 In addition the government enjoyed widespread donor support which ensured development and budgetary support in addition to encouraging investments. These gains were however negated by

12 Ibid pp 3-7
the emergence of new corruption scandals and even worse by the disputed elections of December 2007 and the resultant post-election violence. The violence had serious effects on the economy and badly dented Kenya's image as a peaceful country suitable for foreign investors. The culmination of the reforms required to ensure that such a problem never recurs has been the enactment of a new constitution which promises greater economic and political accountability in the government.

In spite of its poor performance over the past two decades and the recent global economic crisis, the economy of Kenya is slowly rising again and despite many difficulties, the country still benefits from a larger economy than all its immediate neighbours and partners in the East African Common Market. In 2010 Kenya's GDP per capita was estimated at US$ 66.03 billion against US$ 58.49 billion and US$ 42.16 billion for Tanzania and Uganda respectively. In addition to this the Kenyan economy, is said to be more diversified with stronger service and industrial sectors and is less dependent on agriculture. Less dependence on a primary sector such as agriculture or mining and a stronger manufacturing and service sectors are generally perceived as an ingredient for take-off towards economic growth and development.

Agriculture remains the mainstay of the economy providing livelihood and employment to an estimated 75 percent of Kenya's population and accounting for 24 percent of GDP in 2007. This sector was for long dominated by coffee and tea exports. However, poor world market prices for coffee reduced this crop's share of GDP contribution. On the other hand, floriculture and horticulture have grown fast and are today Kenya's most important sources of export earnings after tea. The services sector also gained considerable importance with tourism

registering high growth rates despite recent downfall in number of tourists due to global terrorism threats of which Kenya has been a victim and the 2008 post-election violence which resulted in travel advisories in several Western countries. Growth in the information communication technology and financial sectors has also been impressive and currently, the service sector is the largest contributor to national GDP at an estimated 63 percent.\textsuperscript{17}

Manufacturing as a share of total production has fluctuated throughout the past couple of decades. The sector has not been able to compete in global markets and has lost market share in its traditional export markets within the region and contributions to GDP are estimated at 13 percent similar to the level in the mid 1960s.\textsuperscript{18} Figure 2 below shows a graphical presentation of the economic performance of Kenya as measured in real GDP growth rates between 1980 and 2010. The figures serve to demonstrate the under-performance and erratic nature of the economy over the three decades. The highest growth rate recorded during this period was 6.9 percent which is low by world standards for any meaningful growth to be attained. Whereas economic growth in Kenya is a function of many factors, the performance shown here helps to lay the basis for the argument that is in Kenya’s national interest to welcome all benevolent economic cooperation including FDIs from different countries who are willing to bring in investments in order to achieve sustainable growth.

\textsuperscript{17} Ibid
\textsuperscript{18} Ibid
3.2 Trends of FDI in Kenya

FDI in Kenya grew steadily through the 1970s as Kenya was a prime choice for foreign investors seeking to establish a presence in Eastern and Southern Africa. The relatively high level of development, good infrastructure, market size, growth and openness to FDI at a time when other countries in the region had relatively closed regimes all contributed to Multinational corporations choosing Kenya as their regional hub. FDI started at a low of around $10 million a year in the early 1970s before peaking at $80 million in 1980.19

The poor economic performance coupled with problems of corruption, governance, inconsistency in economic policies and structural reforms and the deterioration of public services and infrastructure generated a long period of low FDI that started in the early 1980s and

continues to date.20 Inflows of FDI in the period 1981-1999 averaged only $22 million a year. Although the sale of mobile phone licenses to Kenyan-foreign joint ventures pushed FDI to over $100 million in 2000, inflows fell again to around their average of the 1980s and 1990s, before rising again in 2003 thanks to textile investments in export processing zones (EPZs).21 The inflows between 1990 and 2009 are shown in the Table I below: To get a better picture of the performance of the country as a FDI destination, comparison is made with inflows to the neighbouring countries of Tanzania and Uganda. The figures show that Kenya’s performance as a destination for FDIs was the poorest. In the case of Tanzania, political stability and mineral resource endowments helps it to attract FDI. In the case of Uganda, stability after many years of political unrest and a lot of donor support has been contributing factors. This trend is expected to continue now that Uganda has discovered oil deposits due for extraction by multinationals in the near future. Most interesting though, is that while Kenya is losing out on FDIs to its neighbouring countries, it is a major source of FDI inflows to Uganda where it ranks third after United Kingdom and China and also to Tanzania where it is ranked second after United Kingdom. The two countries on the other hand do not rank as significant investors in Kenya.22

21 Ibid
22 Tanzania Investment Centre, *Benchmarking Tanzania’s Foreign Direct Investments* (Dar-es Salam, Ministry of Trade 2008)
Table 3.1: FDI inflows to Kenya, Uganda and Tanzania- 1990-2009

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<tr>
<th>Year</th>
<th>FDI inflows (Millions of Dollars)</th>
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Source: UNCTAD, World Investment Report 2010

Although Kenya was the lead destination of FDI to the East African Community (EAC) in the 1970s and 1980s, the relative level of inflows was estimated at only 7.5 percent of GDP in 2009 as compared to 15-20 percent of GDP in the cases of Tanzania and Uganda in the same year.23 Kenya's regional leadership in attracting FDI disappeared as soon as Tanzania and Uganda

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started reforming their economies and opening up to foreign investors in the early 1990s, at a time when Kenya was experiencing economic stagnation. The end of apartheid in South Africa in 1994 also increased competition in the attraction of large MNCs seeking a single production or headquarter centre in Anglophone Africa. FDI inflows in 1996-2003 averaged $39 million a year, while inflows to Tanzania and Uganda surged to $280 million and $220 million, respectively, from low levels in the 1980s.\textsuperscript{24} While developing countries as a whole attracted an annual average of $41 of FDI per capita in 1996-2003, Kenya only drew average inflows of $1.3 per capita. This ranks Kenya as 129\textsuperscript{th} out of 140 countries on UNCTAD's FDI performance index in 2001-03. It has also never ranked better than 111\textsuperscript{th} at any time since 1990.\textsuperscript{25}

The factors behind Kenya's poor performance at attracting FDI at a time of a global surge in flows, including to its most immediate neighbours with similar economic structures, are found mainly within the country. The lack of significant progress in economic reforms over the past decades, prevalence of corruption, mediocre growth performance, deterioration in the quality of infrastructure and rising cost of services are all major factors that have hampered FDI. The slow pace of large-scale privatization programme designed to attract large foreign investments, the country's limited mineral resources and worst of all the country's investment framework make Kenya not a very attractive FDI destination.

Although the government has sold its stakes in several parastatals especially in the telecommunications sector several privatization plans are still pending. Others like the concessioning of the Kenya Railways to a private operator have not been successful because the operator identified apparently lacks the financial capacity to introduce new technology, expand the existing facilities and turn the corporation into profitability. Very little investment has taken

\textsuperscript{24} Ibid
\textsuperscript{25} The performance index is calculated as the ratio of a country's share in global FDI inflows to its share in global GDP

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place in mining, not only because of limitations in terms of resources and government bureaucracy but also because of differences in mining and land policies. While the government encourages investors in mineral prospecting and extraction, government land acquisition procedures especially for foreigners are difficult. It is even more difficult when mining operations are planned in private land. Tiomin Mining Company a private investor from Canada has for close to ten years not been able to commence its titanium mining operations in Kwale because the government has not resolved issues of compensation for local population that was meant to be displaced to pave way for mining operations.  

Although the government of Kenya has made huge efforts since 2005 to rehabilitate the road network in the country, infrastructure and rising energy costs are still blamed by both local and foreign investors as the biggest contributors to the high cost of doing business in the country. Investors in the crucial tourism sector have for long lamented the poor state of roads in key tourist circuits such as the Masai Mara that forces them to resort to chartered flights and hence increasing their costs. The high cost of doing business has also induced many foreign investors already established in the manufacturing sector to divest their operations out of Kenya in recent years. Although high costs are blamed, divestiture by some corporations including among others, Exxon-Mobil, Caltex, Procter and Gamble, Johnson and Johnson and Colgate Palmolive has taken place partly as a consequence of worldwide strategies of consolidation of production centres. Small economies in Africa do not fit into the strategic plans of some of these corporations. The consequence has been that Kenya has in general been on the "moving out" side of the equation rather than the "moving in" side as a result of its relatively high operation costs and new global business trends. It is noteworthy that the MNCs that have been consolidating

27 Ibid p 6
out of Kenya are of American or European origin. Few investors from these regions have been coming in and the existing investors have not been planning significant expansion. On the other hand Chinese Companies have been coming to Kenya in bigger numbers as will be seen later in this study.

Although it would not change the overall assessment of under-performance in FDI attraction, poor data collection most probably under-estimates actual inflows of FDI to Kenya. There is no clear mandate by any agency to collect data on FDI and the Central Bank of Kenya, Kenya Investment Authority or Central Bureau of Statistics all collect only partial information on either balance of payment flows or investment projects. The result of this is that the presence of a large number of major and minor MNCs in Nairobi and in other towns indicates that the impact and prevalence of foreign investment in Kenya may be larger than is captured by official statistics. The fact however is that the level of FDI has been low and stagnant over the past couple of decades, and well below Kenya's potential.

3.3 Sectoral Investments in Kenya.

The most significant recent inflows of FDI to Kenya are investments in the horticulture, floriculture and textiles, in addition to investment in tourism. Interest in horticulture and floriculture has been in response to favourable local conditions linked to climate and transport infrastructure. Foreign investors play a major role in floriculture and horticulture, with close to 90 percent of flower production controlled by foreign affiliates. The initial development and growth in horticulture was favoured by development in the tourism sector. Frequent passenger air connections with Europe offered the essential cargo space for transporting fresh produce from

29 Ibid
Kenya but rapid growth in export volumes subsequently made the use and development of cargo facilities economical. In addition the favourable EU-ACP trade agreements between the European Union (EU) and some African, Caribbean and Pacific countries (ACP) of which Kenya is a member has greatly boosted the country’s horticultural exports.30

Manufacturing FDI was for a long time concentrated on consumer goods sectors. This has changed in recent years with the growth of the textiles sector due to American Growth Opportunity Act (AGOA). Most foreign investment in manufacturing since 2001 has been in the Export Processing Zones (EPZs), with the majority in AGOA-related textiles. There are currently more than 70 enterprises operating in EPZs31. The EPZs have expanded from their initial textiles focus to also produce a number of other goods, though the domination of textiles remains strong. The largest investment in the non-garment sector is the De La Rue currency printing operation. Of the companies producing garments for the US market, the majority are foreign-owned.32

AGOA related investments in the past few years have represented a large portion of FDI in the country. Though these investments have increased employment and exports, the dominance of garments-related FDI is of concern as it may not be sustainable. This is because of the anticipated ending of AGOA quotas in the near future and the integration of trade in textiles and clothing under normal WTO rules. It is likely that China and other Asian countries will supply a large part of the US apparel market due to their cost and quality advantage over many countries, including Kenya hence the uncertain future of this arrangement.33

30 The Lomé I-IV and Cotonou agreements allowed for non-reciprocal duty free access by ACP country exports to EU markets. The new Economic Partnership Agreement (EPA) currently being negotiated may require reciprocity by ACP members in the case of EU goods
32 Ibid
FDI in services has been directed to a wide array of sub-sectors, including tourism, financial and business services and telecommunications. The country’s diversified tourism sector has been a major attraction for foreign investment. Tour operators are dominated by foreign operators such as United Touring Company (U.K.), Express Travel (U.S.), Abercrombie and Kent (U.K.) and Pollmans (Germany). Foreign investors also the major international hotel chains present, including Hilton, Intercontinental, Serena, Block Hotels and Holiday Inn and most of the hotels and lodges at the coast.34

Kenya has also attracted foreign investors in banking and professional services. Companies such as Pricewaterhouse Coopers, Deloitte and Touche, Ernst and Young, Ogilvy and Mather among others base their main East African operations in Kenya. There are several foreign banks in Kenya including Barclays, Standard Chartered, Citibank, Stanbic, that control more than 50 percent of total banking assets in the country. 35 The power generation sector has also had investment through the award of Independent Power Producer (IPP) contracts to foreign investors: IberAfrica Power (Spain), Westmont Power (U.S.), OrPower4 (U.S.), and a consortium, Tsavo Power.36

Foreign investors have been most active in the telecommunication sector. The four mobile phone operators are all foreign investors with varying shareholding ratios by the Kenyan government and public. Safaricom is 40 percent owned by Vodafone of the U.K. and Airtel is fully owned by Bharti of India. Orange is majority owned by Telecom of France while YU is owned by Essar Communications of India37

37 Ibid pp 15-17
3.4 Types of Foreign Direct Investment in Kenya

In the agricultural sector and in particular the horticultural sub-sector, the form of entry of FDI has been primarily through the setup of Greenfield operations. Greenfield operations are those involving set up of subsidiaries from the ground up as opposed to acquiring existing businesses. The Government's privatization drive in the 1990s led to the sale of many enterprises, though with the exception of Kenya Airways these were small and medium size companies, and most of the buyers were Kenyans. The largest sales to date have been the acquisition of 26 percent of Kenya Airways by KLM in 1996 and the acquisition of 10 percent of Telkom Kenya by France Telecom in 2008. The government is planning more privatizations, with several companies in the energy, finance and communications subsectors identified for full or partial sale. The methods of sale will range from concessioning to sale on the Nairobi Stock Exchange or securing a strategic partnership with a major player in the relevant sector.

3.5 Origin of Foreign Direct Investments to Kenya

More than 200 MNCs operate in Kenya. The traditional sources of investment are the United Kingdom, Germany, and the United States. The British are the largest group, with most long-standing investors including Barclays, Standard Chartered in banking, British American Tobacco in cigarettes manufacturing, and Brooke Bond in Tea growing and processing among several others. The latest British investments include Vodafone in telecommunications and De La Rue in

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40 Ibid
41 Ibid

58
currency printing. Other European countries including Germany and France also have large investments in the country. Among other investors, the French company Lafarge owns Bamburi cement, the largest cement manufacturer in the country.

The value of US investment is estimated at around $285 million, primarily in commerce, light manufacturing, and the tourism industry. Major US investors are General Motors, Eveready Batteries, Colgate Palmolive, Sara Lee, and Wrigley.

South Africa is a growing source of investment in diverse sectors. Major investors are mainly in services - Stanbic in banking, Shoprite and Metro Cash and Carry in retail, Protea Hotels, Nandos and Steers in restaurants, and Engen in petroleum products.

Participation from Asian countries, including China, India and Japan, though smaller than that from the West, is rising. China in particular is becoming an increasingly important source of FDIs with more than one hundred investors setting business in Kenya over the last ten years as will be discussed later in this study. The recent visit by the President of Brazil to Kenya is expected to result in investments from the South American nation and further diversify sources of FDIs in Kenya.

3.6 Impact of Foreign Direct Investments on Kenya's economy

Although the inflows of FDI have been low over the past decades, its impact on the economy though still below expectations cannot be underestimated. Foreign investors have contributed significantly to some of the more dynamic sectors in the economy, including horticulture, and to export diversification. FDI have benefited the Kenyan economy in several ways;

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43 Ibid pp 14-15
44 Ibid pp 12-13
3.6.1 Source of Capital and Investment

Private and public domestic investment have fallen in the past three decades due to poor investment climate, high external indebtedness, low domestic saving and a generally weak economy. These factors and policies have generated a sharp contraction in public investment in infrastructure and social services, reduced the availability of funds for private investment and increased their cost. Persistent government budget deficits have also contributed to the scarcity and high cost of funds for domestic private investors. FDI as earlier explained in the growth theories, is a potential source of capital and can help in closing the gap between savings and domestic investment. However, in the case of Kenya FDI has not played a significant role in this regard. In the period 1996-2003, FDI inflows represented only 2.4 percent of gross fixed capital formation (GFCF), compared with 11.4 percent for Africa and 12 percent for developing countries as a whole.45

Some of the significant contributions of FDI to capital and investment in the country have occurred in the telecommunications sector, where the four mobile phone operators have led to the rapid development of the sector largely financed by foreign investors. The competition introduced in mobile telephony has resulted in sharp increase in the quality of telecommunication services and an even bigger increase in mobile phone usage currently estimated at 20 million.46 The entry into power generation sector by Independent Power Producers in late 1990s has allowed an increase in power supply to the extent that these investors currently account for about 20 percent of total capacity.47 Given the successes in the telecommunications sector it is unfortunate that the private sector has not been allowed to play

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significant roles in other infrastructure sectors such as ports, airports, roads, and water or electricity distribution. However, there are indications that the government is planning greater private sector involvement in these sectors in the future, as part of its renewed privatization drive.

3.6.2 Technology and Skills transfers

Technological transfers have taken place mostly through transfers of managerial skills and processes. Formal research and development is low and is confined to a few large enterprises. The operations of foreign enterprises in manufacturing are largely in the production of low-end consumer and agro-processed goods for the local and regional market and textile operations for the AGOA market. There are a few cases of more complex technology use or use of advanced processes in manufacturing, as with General Motors in vehicles, and Tetrapak in packaging.

FDI has nonetheless played an important role in introducing technology and knowledge in horticulture and floriculture. This has enabled the sector to become a leading exporter of high value products to the European market. Investors have put in large amounts of capital for land preparation, setting up of irrigation systems, greenhouses, refrigerated storage and staff welfare facilities and the results have been world-class facilities producing for the most competitive markets in the world. One company, Dutch-owned Oserian Fastac has installed one of the world’s biggest geothermal heated greenhouses in order to control diseases and increase yields of rose flowers through more uniform temperatures while another company Homegrown, the largest producer of flowers and vegetables has recently introduced wireless data communication linking their production, cooling and packing facilities in Kenya with order information from their customers in Europe.48

FDI has also been at the root of transfers of skills to local workers. This has been possible due to the relatively high level of general education that gives Kenya a big pool of English speaking human resource that investors can draw from and easily train. Foreign firms often provide continuous training programmes for their local employees that allow them to occupy middle and top management positions. Many multinationals in the country are as per Government of Kenya requirements for limiting expatriate employment and creating employment for Kenyans, are characterized as having only a few top posts, often managing director and finance director staffed by expatriates while the middle level management and other staff are recruited locally.

Skill levels in Kenya are sufficiently well regarded going by the increasing trend for Kenya to be the regional headquarters or services hub of multinationals. Headquarters functions such as accounting and strategic planning are in many companies maintained in Kenya for East African operations even when production lines are relocated. Such multinational corporations as asset managers Old Mutual manage office operations for Tanzania and Uganda, Rwanda and Burundi from Nairobi. There are also many Kenyans working for Kenyan based multinational corporations operations who staff offices in the region which is a manifestation of the relatively high skills levels in Kenya.

The presence of foreign banks has had a positive effect on the local banking sector. Foreign banks as a group, display greater efficiency than their national competitors as evidenced by the two highest performers Barclays and Standard Chartered Banks. Due to the high levels of competition and the entry of new banks from South Africa and Nigeria, local banks such as

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50 Ibid
Equity, Kenya Commercial, National and Cooperative have greatly improved the quality of their services hence lowering the financing costs faced by local corporate and retail borrowers.\textsuperscript{51}

3.6.3 Creation of Employment and Linkages

FDI has also been an important source of employment in Kenya. EPZ employment, accounted for a large percentage of total formal manufacturing employment between 2003 and 2010.\textsuperscript{52} Foreign investments have also significantly contributed to output and employment growth is horticulture, which is also labour intensive with an estimated 2 million people employed directly and indirectly as of 2010.\textsuperscript{53} These positive developments have been offset somewhat by the loss of employment in traditional sectors of foreign investment in the manufacture of consumer and other goods. Manufacturing employment suffered a net decline between 1998 and 2005 when such large multinationals as Unilever, Colgate-Palmolive and Cadbury-Schweppes shifted production to other countries.\textsuperscript{54}

Linkages with foreign investors have been most significant between agro processing investors and the large domestic agricultural sector. Out growers are used extensively by horticulture packagers. It is estimated that purchases by leading exporters from smallholders account for 27 percent of exported fresh vegetables and 85 percent of exported fresh fruit.\textsuperscript{55} Homegrown, the country’s leading horticultural producer, for example, has over 1,000 out growers in its operations in Timau area of Nanyuki. The company operates a support policy for these out growers providing them with the seed, technical expertise and training necessary to produce high

\textsuperscript{51} Central Bank of Kenya, Annual Report 2009, Nairobi
\textsuperscript{52} Central Bureau of Statistics, Statistical Abstracts 2010, Nairobi
\textsuperscript{53} Ibid
quality products.56 There are also supplier linkages in manufacturing, such as General Motors in motor vehicle assembly. Linkages are limited in the textiles sector due to the importation of most raw materials from Asia. Local cotton farmers have not benefited as local products cannot compete with cheaper imported lint.

3.6.4. Diversification of Exports

As a developing economy, trade is vital to Kenya's development. The economy is relatively open with total exports and imports of goods and services representing around 60 percent of GDP over the past few years.57 Merchandise exports are dominated by a few key goods and markets, with FDI playing an essential role in the more dynamic sectors of horticulture and garments. Horticulture has become the country's main agricultural export, closely competing with tea. The export boom in flower and vegetables has been dominated by the production of foreign investors. Cut flowers represent the largest share of volume (46 percent), followed by fruits (37 percent) and vegetables (17 percent).58 Sales are mostly to Europe, which accounts for 95 percent of fresh produce exports. Kenya now accounts for 25 percent of European flower imports from non-EU countries, exceeding the shares of the next two largest suppliers, Colombia (17 percent) and Israel (16 percent) 59

In Kenya, tourism account for the largest percentage of exports of services. Foreign investors are active in all segments of this sector, including hotels, resorts, restaurants, and travel and safari agencies. The success of Kenya Airways since its privatization in 1996 and the involvement of KLM of the Netherlands has been key to the success of the sector. Exports of air passenger services, which is dominated regionally by Kenya Airways, has significantly increased

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56 Ibid
58 Federation of Dutch Flower Auctions (VBN), Annual Report, Amsterdam 2007
as a result of the company raising the level and extent of its services and increasing the role of Jomo Kenyatta airport as a regional hub\textsuperscript{60}.

In recent years garments have become the country’s fastest growing manufactured export in response to the AGOA agreement with the U.S. Kenya’s garments exports to USA earning the country US $255 million in 2007.\textsuperscript{61} Kenya just as Lesotho, Madagascar, Swaziland, South Africa and Mauritius have taken advantage of AGOA to expand apparel exports to the USA. In 2003, Kenya was the fifth largest AGOA exporter of apparel to the USA, with about half the level of exports of Lesotho, and also behind Mauritius, South Africa and Madagascar.\textsuperscript{62}

3.7 Impediments of FDI in Kenya

In the 1970s, when the country received relatively large capital inflows, various factors were in favour of attracting the FDI. Although during the period the country suffered from macroeconomic instability, the market size was favourable, with a high GDP growth rate and a large regional market that included the East African Community (EAC). Similarly, the adopted industrial strategy favoured the net FDI inflows especially the market-oriented type.\textsuperscript{63}

The 1980s experienced declines in FDI inflows. This was a period when due to the implementation of structural adjustment programmes, there was uncertainty arising from policy reversals and the shift away from import substitution to an export-oriented industrialization strategy. The 1980s were thus characterized by deterioration in the GDP growth rate and, following the collapse of the EAC in 1977, a reduced regional market. There were at the same

\textsuperscript{60} Ministry of Tourism Kenya \url{http://www.tourism.go.ke/} last accessed 21 June 2011

\textsuperscript{61} Central Bank of Kenya, Annual Report 2009, Nairobi

\textsuperscript{62} Kenya Embassy in the USA \url{http://www.kenyaembassy.com/pdf/AGOAbrief.pdf} Last accessed 20 June 2011

time significant changes in the political system, especially with the introduction of single-party political system, which reduced the level of democracy in the country which in turn strained relationships between the country and donors who are also the sources of FDIs. 64

The 1990s were characterized by the implementation of the World Bank and IMF initiated structural adjustment programmes. The period saw the removal of import controls and relaxation of capital controls, making the economy more open. A free foreign exchange regime eased the repatriation of dividends by foreign investors. This, together with the removal of barriers to foreign commercial private borrowing, provided a more enabling environment for foreign investors. Furthermore, the government put up various incentives to attract investment such as the establishment of EPZs which allowed unrestricted foreign ownership and employment of expatriates as well as non control over foreign exchange earnings in addition to extensive tax advantages.65 Despite these, economic performance was weak and any improvements in macroeconomic parameters were offset by rising costs of doing business, ethnic clashes and corruption. The weak economic performance was attributed to among other things the failure to sustain prudent macroeconomic policies, the slow pace in structural reforms and governance issues. This type of macroeconomic status was not conducive to attract either market-driven or cost-saving FDI.

The reform process in the 1990s included efforts to establish a democratic government but more was needed to strengthen the democratic system, especially through the review of the constitution. The demand for constitutional reform caused a lot of political tension and uncertainty to the investors. Although the government was generally stable, many of the socioeconomic and political indexes deteriorated. In the absence of significant public sector

64 Ibid
reforms, and with reduced political pressure on policy formulation systems, policy instability was still an issue the investors had to contend with. Similarly, with the government’s slow pace in dealing with governance issues, corruption was a major cost to the business community. The period also saw tribal clashes accompany the multi-party elections in 1992 and 1997, adversely affecting the distributional systems and demand patterns of goods and services.

This background contributed to poor relations between the government and the donors, which undermined the perceived goodwill to foreign investors. The 1990s saw the donors suspend balance of payment support until the government fulfilled certain political conditions. There were delays in disbursement especially when the government failed to adhere to the agreed schedule and this made it difficult to achieve the set targets in good time. The dynamism in the conditionalities saw governance issues put as a condition by the IMF for disbursing funds to support the 1996–1998 reform programme. The government- donor relations improved significantly after the elections of 2002 that ushered in a new government. However this government has also had its share of corruption scandals and slow implementation of reforms. These are factors not in favour of an FDI seeking economy. However, perhaps the biggest impediment to FDI to Kenya today is the country’s investment framework.

3.7.1 The Framework for Investment in Kenya

For decades, Kenya had one of the most open regimes for FDI in Africa. The principal restrictions were contained in the Trade Licensing Act (1968). Apart from this Act, the only formal limits on foreign ownership were in telecommunications and insurance (in which foreign ownership of a business is limited by policy to 70 percent and 77 percent respectively) and for

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66 Ibid
companies listed on the Nairobi Stock Exchange, which are required to have at least 25 percent national ownership. Moreover, FDI did not require screening for approval.

New FDI entry requirements were introduced in late 2004, which overturned this approach replacing it with a more restrictive one. The Investment Promotion Act (2004) introduced a mandatory investment threshold and restrictive screening procedure for all foreign investments becoming a significant impediment to FDI inflows. The Act makes a formal distinction between domestic and foreign investors, and requires the latter to apply to the newly established Kenya Investment Authority (KIA) for an Investment Certificate by stating that "a foreign investor shall not invest in Kenya unless [it] has been issued with an investment certificate." The conditions under which KIA is allowed to issue an Investment Certificate to a foreign investor are restrictive and the requirements that the amount invested must be at least US $500,000 or the equivalent in another currency; that the investment must be deemed by KIA to be to the benefit of Kenya, including at least as a result of the creation of employment for Kenyans, the acquisition of new skills or technology by Kenyans and the contribution to tax revenues or other Government revenues. Other factors such as the contribution to foreign exchange earnings or utilization of domestic inputs are also to be taken into account.

The legislature that introduced mandatory Investment Certificates and smallest amount of capital requirements for foreign investors and reporting obligations for domestic investors did so for two main purposes: - to improve weak data collection on domestic and foreign investment and to ensure that the entitlement to foreigners work permits granted as an incentive to holders of Investment Certificates is not abused to illegitimately bring in foreign workers. The methods
chosen under the Act to address these two concerns, however, have detrimental side-effects on legitimate and beneficial FDI.²¹

The $500,000 requirement negatively affects FDI in non-capital intensive projects in the services sector which is a strategic focus for Kenya's attraction of FDI. It also stimulates the practice whereby smaller foreign investors engage citizens to "front" for them as owners of businesses. This leads to corrupting temptations on government officials. The requirement to screen all FDI proposals is a measure that is better applied to determine the eligibility to incentives for qualifying investors rather than to decide on the entry of FDI. It may not be appropriate in a market economy for a government to prevent an investment because it does not create "sufficient" jobs or exports in the government's opinion.²²

3.7.1.1 Treatment and Protection of FDI

In general, foreign investors receive the same treatment as domestic investors once established in Kenya. The main deviation from national treatment is in terms of access to agricultural land. The Land Control Act (1967) specifically forbids noncitizens and private companies any of whose members is non-citizen to acquire or lease agricultural land. The Act nevertheless also allows the President to grant exemptions to the restrictions, without having to provide justification or impose conditions on the transaction. His discretionary power in this matter is thus total and not limited by law.²³

Protection of private property, including for foreign investors, is enshrined in the Constitution. Private property may be compulsorily acquired by the Government only for reasons pertaining to public safety or public interest, and with "prompt payment of full compensation". The owner of

²² Ibid
the property also has a right of direct access to the High Court if he wishes to contest the legality of the expropriation, the amount of the compensation, or to enforce prompt payment of the compensation.74

Foreign investors also have the option to have recourse to the International Centre for Settlement of Investment Disputes (ICSID), as Kenya has been a member of the Convention since 1967. Recourse to ICSID for conciliation or arbitration requires consent of both parties involved in the dispute, as specified by the ICSID convention. The Investment Disputes Convention Act (1967) stipulates that awards granted by the ICSID Arbitration Tribunal are binding in Kenya and have the same validity as final decrees of the High Court.75 Kenya is also a member of the Multilateral Investment Guarantee Agency (MIGA), which allows foreign investors to seek cover for currency transfer risks, expropriation, breach of contract or war and civil disturbance.76

Kenya has negotiated Bilateral Investment Treaties (BITs) with Germany, Italy, the Netherlands and the United Kingdom. Of these, only the latter two have been ratified and come into force. In contrast, Uganda has 11 BITs ratified or under negotiation, Tanzania 10, and Egypt 88.77 The provisions in the BITs are standard in that they provide for national treatment as regards management, maintenance, use, enjoyment or disposal of investment, most favoured nation status and compensation for war, national emergency and other related losses. They also guarantee transfer rights and provide protection against arbitrary expropriation and prompt, adequate and effective compensation in case of expropriation. The BITs usually bind the States

74 Ibid
75 Ibid
76 Ibid
to consent to international arbitration to ICSID if the investor requests it, and if local remedies have been ineffective after a set period of time.78

3.7.1.2 Measures for regulating business

Kenya's tax system is relatively straightforward and is not widely used to provide targeted sectoral incentives. The administration of the system is said to be efficient and fair relative to other developing countries. Investors' concerns about the tax regime are focused less on the structure of the system itself or the level of taxation, but more on what they perceive as a rather "aggressive" attitude of the Kenya Revenue Authorities (KRA) with respect to compliant taxpayers, and the "punitive" levels of penalties in case of delay in payments or minor mistakes in reporting. Investors are also concerned by what they perceive as punitive penalties on delays on their part. The VAT Act imposes penalties of 2 percent per month compounded on late payments. The Act also allows the VAT Commissioner to recover unpaid tax liabilities by seizing assets instead of suing the taxable person.79

Although the tax regime is generally appropriate and competitive, both within the region and globally, a few issues raise significant concern for investors and are impediments to the use of Kenya as a business platform for the region. The main concerns include; double taxation on profits or income from operations within the region, the imposition of withholding tax on agency and consultancy fees between two resident entities which generates a heavy burden on the cash flow of emerging services companies that may not generate significant profits and hence qualify for refunds once income tax returns are filed and the issue of transfer pricing. The KRA has not determined clear guidelines as to how companies should determine transfer prices, however, and they have not adopted the widely accepted OECD principles. This absence of guidelines remains

78 Ibid
79 Ibid pp 32-34
a concern to investors, who currently face uncertainty regarding KRA’s position vis-à-vis their
methods of assessing transfer prices, and hence their tax base.  
Special incentives are provided for enterprises operating in Export Processing Zones under the
Export Processing Zones Act. In addition to procedural incentives including exemption from
certain licences, facilitation services by the Export Processing Zones Authority and the higher
quality of infrastructure, several fiscal incentives are granted to companies operating in EPZs.
These include exemption from taxes and duties payable under the Customs and Excise Act and
Value Added Tax Act on imports for use in the eligible business activities of the EPZ enterprise,
exemption from registration under the VAT Act, exemption from the payment of income tax for
the first ten years from the date of first sale, followed by a rate of 25 percent for the subsequent
ten years, exemption from the payment of withholding tax on dividends and other payments
made to non-residents for the first ten years, exemption from stamp duty and exemption from
any quotas or other restrictions or prohibitions on imports or exports, with the exception of trade
in firearms, military equipment or other illegal goods.  
Apart from taxation, there are other guidelines by stipulated the government of Kenya aimed at
regulating business in and they include in the key aspects of foreign exchange arrangements,
labour regulations, employment of foreigners, land, environmental regulation, regulation of
competition, intellectual property rights among others.  

80 Ibid pp 40-45
accessed 18 June 2011
3.8 Conclusion

From the discussions above, it is evident that over the last decade to 2001, Kenya has lost its competitiveness in attracting new investment. Kenya has also lost in terms of retaining the existing stocks of investment. The loss in Kenya’s investment competitiveness is the result of many inter-connected factors such as negative perception by investors about political instability, poor governance, corruption, inadequate infrastructure, insecurity, crime, and policy instability. This loss of competitiveness relates specifically to attracting and retaining the traditional Western originated FDI because of the reasons mentioned above and largely also because of global realignment of the strategies of the MNCs from these countries.

The loss in Kenya’s competitiveness to attract Western direct foreign investment has meant that any FDI flows from other countries such as China have constituted an important proportion of the Net FDI flows in Kenya. China has adopted a new policy to Kenya, aimed at closer ties in economic cooperation. There is an increase of Chinese FDI aimed at the manufacturing and service sectors in Kenya. Chinese interest in Kenya has also extended to mining, minerals exploration and infrastructure construction. These are sectors that previous FDIs from the West did not venture into. The revival of the country’s infrastructure sector with the help of Chinese is of particular importance as the collapse of the infrastructure has been variously blamed for Kenya’s inability to attract sufficient FDI.

There is therefore an increased presence of Chinese enterprises but the importance of China’s FDI flows to Kenya is much more in terms of capital investment rather than the quality of activities. This is because Chinese companies have tended to engage in services such as trade with very few firms participating in manufacturing. In addition, the trade, investment and aid figures between Kenya and China are small when compared to other trading partners of Kenya.
such as the European Union (EU) and the USA but it is the different way that China engages
with the government totally in contrast with Western development partners that shows that China
may in future be largest source of FDI in Kenya.

The next chapter therefore focuses on Chinese FDIs in Kenya with an attempt to analyze the
reasons why there is an increased Chinese investment in Kenya, why Kenya is encouraging these
investments and to collect evidence on the impacts of the FDIs on Kenya’s desired economic
growth.
CHAPTER FOUR

AN ANALYSIS OF CHINA’S FOREIGN DIRECT INVESTMENTS IN KENYA

4.0 Introduction

Chapter two analyzed the relationship between Foreign Direct Investments and economic growth. FDI has been shown as a means through which new capital can be brought into an economy thus augmenting domestic capital resources. FDI is a possible avenue for the introduction of new and more efficient technology to replace or enhance existing manufacturing technologies and all geared towards increasing the productive capability and capacity of an economy. In relation to these two benefits, FDI is also seen as an important means of enhancing the export capability of a country as well as creating employment opportunities and positive backward linkages between the foreign investors and local producers. Despite the existence of known drawbacks of FDI, the gist of the arguments in these chapters has been that in today’s globalizing world, FDI is beneficial to a recipient economy and may lead to desired economic growth and development.

Kenya is a developing economy which requires annual economic growth rates of at least 10 percent so as to raise the living standards of its people and address the massive poverty levels in the country.1 This goal has however been hampered by many factors both economic and political.2 Chapter three traced the economic performance of the country since independence including its performance in attraction of FDI as possible economic growth enhancer and the overall picture has been one of underperformance. While Kenya due to its strategic location in

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1 Ministry of Planning and National Development, Kenya Vision 2030, (Government Printer 2007)
East Africa was a prime choice for foreign investors seeking to establish a presence in the region in the 1960s and 1970s, a combination of poor economic policies, political problems, corruption and substandard public services and poor infrastructure discouraged FDI since the 1980s. Since 2003 however, Kenya’s performance in attracting FDI has been better but still below its potential and poor in comparison with FDI inflows to neighbouring countries. UNCTAD’s 2008 World Investment Report described Kenya as East Africa’s least effective suitor in attracting FDI. While the country has made big efforts to streamline political and economic factors which were in the 1980s and 1990s blamed for making the country unattractive as an FDI destination, the costly investment climate in the country is among other factors an impediment to greater foreign investments in the country.

The fact however remains that Kenya still seeks to attract increased FDI to spur economic growth and development. The Kenya Vision 2030, which covers the period 2008 to 2030, is the government’s current blueprint towards transforming the country into a newly industrialized middle-income country by the year 2030. The Vision 2030 is a strategic plan aimed at guiding the country towards this goal by anchoring the country’s economic, social and political pillars on macroeconomic stability, continuity in governance reforms, enhanced equity and wealth creation opportunities, infrastructure and energy among others. To achieve the goals of the Vision 2030, annual growth rates of 10 percent or more over the next two decades are targeted. To generate this growth, one of the strategies that the government has identified is to increase the level and productivity of investment from about 15 to 20 percent of GDP to levels in excess of 30 percent.

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3 Ibid
The country must therefore attract more FDI and concessional finance than it currently does.\(^6\) With traditional Western FDIs not increasing or new ones coming in at desired levels, China is increasingly playing a big role as Kenya’s development partner and source of investments. Since 2002, Kenya has nurtured close relationship with China and Chinese companies have in the past five years established strong presence in Kenya’s telecommunications, infrastructure, automobile, battery, apparel, food and beverages markets cutting down the dominance of subsidiaries of western multi-nationals.\(^7\) This chapter analyzes China’s investments in Kenya and using data collected from government ministries and agencies, local and foreign businesses, examines the impact of these investments on the Kenyan economy.

4.1 A review of China – Kenya diplomatic relations

The current diplomatic relations between Kenya and China dates back to Kenya’s independence. The People’s Republic of China was the fourth state to establish diplomatic relations with the Republic of Kenya on December 14, 1963.\(^8\) Kenya, like other countries with diplomatic relations with China, subscribes to the ‘One China Policy’ which means that it does not support Taiwan’s calls for independence and reiterates that it is an inalienable part of Chinese territory.\(^9\)

China-Kenya relations, was from the beginning centred on promoting trade between the two countries. However, the relationship faced difficulties almost immediately with China being closely identified with the left wing of the ruling party in Kenya. The wing that was headed by the then Vice President Oginga Odinga was thought to have communist intentions for the

\(^6\) Ibid
\(^7\) Juma Victor, “Chinese Manufacturers go local in battle for Kenya’s consumers”, Business Daily (Nairobi, April 2011)
\(^9\) Ibid

77
country. The then Kenyan President Kenyatta felt that China’s perceived revolutionary agenda was in conflict with Kenya’s and its Western allies’ capitalist interests and relations between the two states deteriorated, ending in diplomatic break in 1967. This break in relations stayed thus for a decade and did not improve until after Chairman Mao Zedong and President Kenyatta exited from leadership in 1976 and 1978 respectively.

In 1978, when President Daniel Moi became president in Kenya, relations between the two countries were strengthened. The trade component of this relation was reinforced in the same year when under the leadership of Deng Xiaoping, China started implementing trade reforms and outward oriented programmes. With frequent mutual high level visits the friendly cooperation witnessed outstanding achievements in many fields. In 2002 when a new government under President Mwai Kibaki was formed, there were indications of Kenya’s wish to deepen and expand the cooperation China and indeed, Kenya has remained an active member of the Forum for China-Africa Cooperation (FOCAC) which is China’s vehicle for collaboration with African countries.

Bilateral economic and trade relations have expanded and both countries have also made big steps in cooperation in other areas such as energy, communications, investment and project contract, training and cultural exchange programs and close consultations and cooperation in international affairs. The two countries have signed several bilateral accords over the past ten years which have covered a variety of fields including among others the economy, technology, energy, tourism, health, aviation, the press, archaeology and education.

References:

Today, China is Kenya’s third largest source of foreign investments after the United Kingdom and the United States of America with total investments of more than US$ 80 billion since 2000. Although low in comparison with other FDI inflows into the country, the importance of China’s FDI flows is much more in terms of capital investments in favour of local production that seems geared towards the control of East Africa’s rapidly growing consumer market. In addition, China is also increasingly becoming an important trading partner for Kenya. Although the trade is heavily skewed in favour of China, the figures are a manifestation of China’s growing profile as a trade partner. In 2000 Kenya’s exports and imports to and from China were valued at Ksh 317 million and Ksh 7.7 billion respectively. In 2010, these figures have since risen to Ksh 2.7 billion and Ksh 79 billion respectively. In addition, China is currently the second largest bilateral donor to Kenya with a cumulative Official Development Assistance (ODA) amounting to US$ 56 million behind European Union’s US$ 60 million. Development aid from China supports investments in infrastructure, energy, academic and technical training, medical and military among other fields.

In Chapter three, it was noted that Kenya’s economic performance and ability to attract foreign investments particularly between 1980 and 2002 were below average. The same is true in reference to attraction of development aid in the form of monetary and non-monetary assistance. During this period, the relations between the regime in Kenya and development partners in the West was poor. The poor relations stemmed from among other problems, corruption in the government, slow pace in implementing recommended structural economic and governance reforms, inconsistency in economic policies and the deterioration of public services and infrastructure. When in 2002 a new government was formed in Kenya, relations improved but a

15 Ibid
16 Ibid
combination of problems both internal and external including issues of corruption, cost of doing business, global terrorism, the recent global financial problems and the realignment of priorities by Western multinationals resulting in some of them relocating from Kenya have negated against stronger economic relations with the West.\textsuperscript{17} Against this background, Kenya’s increasingly closer economic ties with China can be understood. This does not in any way imply that Kenya cooperates less economically with the West. In fact Kenya is continuously strengthening economic ties with its traditional development partners while seeking new partners. During the recent visit by German Chancellor Angela Merkel during which the German government pledged more development assistance and investments, Kenya’s Prime Minister Raila Odinga reiterated that; “We are not cooperating with China to the mutual exclusivity of our Western partners”.\textsuperscript{18} This statement may have been sparked by the apparent unease particularly in the West in regards to the increased economic influence of China in Africa at the expense of traditional economic partners. Kenya like other African countries, is exploiting China’s current economic prosperity in terms of trade, investments and development assistance. China is also keen to acquire raw materials, markets, investment opportunities and more political influence in the continent. China has highly succeeded in its strategy and to understand why, it is prudent to briefly examine the differences in how China engages Africa.

4.2 The China - Africa Model

The common explanation for China’s increasing interest in Africa is that China is eager to secure a steady supply of raw materials and in particular oil to sustain its remarkable economic

\textsuperscript{18} Citizen Television, 9 pm News, 12 July 2011; 2120hrs
growth. However, there are other factors behind China's policy of reaching out to countries in Africa in a way that on one hand greatly advances its interests and on the other seems attractive to many African governments. The not so common explanation is that China's economic boom has produced trade surpluses on a massive scale and it is faced with problems of too much liquidity and therefore needs to have somewhere to invest the money. Africa presents a conducive environment for investment because there is relatively little competition from the West and because these investments serve to secure China's strategic objectives.

Another important factor is that Chinese firms have been able to pursue business ventures in Africa that have much higher degrees of risk (in terms of returns to capital) than those pursued by Western firms. This is because most Chinese firms operating in Africa are state owned and enjoy access to capital from state-owned policy banks in particular China Export-Import Bank and China Development Bank. Those firms that are not state owned are provided with insurance so long as they operate in ways that are consistent with China's national interests. Chinese firms can therefore afford to invest heavily in African economies because of their government's support of their outward expansion through credit and insurance support and relaxation of rules restricting capital outflows. This means that Chinese firms operating in Africa can at the same level of cost, pursue riskier projects such as exploration for resources, infrastructure development among others than similar Western firms. In addition to China financially facilitating its firms to invest in African countries, it further ensures that they are awarded government contracts in those countries by offering to fund specific projects such as

20 Holsjag J, China's FDI in sub-Saharan Africa, (Brussels, Brussels Institute of Contemporary China Studies, 2008) pp20-30
22 Ibid
road construction or other major infrastructural undertaking through grants and concessionary loans with the only requirement to the recipient country that the project be awarded to a Chinese firm which will then be supervised and funded by either the Chinese Export-Import Bank or China Development Bank.  

The shift in China's investment strategy to African economies is also ironically being accelerated by the West which has recently become critical of China's increased influence. In the past two decades American and European multinationals have invested billions of dollars in China seeking low cost production due to China's relatively cheaper labour. These investments however led to wealth creation and a rise in China's middle class who using strikes and go-slows pushed up salaries. Combined with inflation this has resulted in higher labour costs and a general increase in costs of production in China. Chinese firms investing in manufacturing in such countries as Kenya are therefore just as the Western multinationals in China also seeking investment destinations where the cost of production is low.

Many African governments including Kenya are increasingly receptive of China's entreaties for varied reasons. First, China can provide much needed funds for development. This is important because many Western countries are providing relatively less aid as compared to the Cold War era or providing aid in ways that are less appealing to recipient countries. During the Cold War era, states received support so long as they aligned themselves with the donor country. After the Cold War however, conditions attached to loans, grants and trade agreements increased and in most cases became burdensome to the recipient states. Currently, it is no longer enough to maintain close political relations to the donor, conditions now reach much further into the country's affairs requiring democratic governance, upholding of human rights, fight against

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23 Ibid
corruption and even dictating for example how much a state should spend on social services, military, education and so forth. Donor countries and financial institutions from the Western hemisphere now demand greater accountability of their monetary support and on any evidence of misappropriation, assistance ceases and they demand for punitive measures against the culprits before resumption of further support. An example is Kenya’s current troubles in the Free Primary Education (FPE) programme in which the alleged misappropriation of about Ksh 4 billion meant for the programme has elicited strong condemnation from the donor, United Kingdom, which has stopped further support for the program and demands a refund of its share of the funds.

Therefore, as donors from the Western hemisphere for various reasons provide less support and become more united in demanding better use of the aid given, and as their demands become more ‘intrusive’, recipient states become more eager to identify other sources of financial support. This is the reason why China’s policy of providing aid or investment based only on the ‘One China Policy’ without demands for social or political changes is an attractive one for some African leaders. China has chosen to take the path of separating business from all other concerns and non-interference in the internal affairs of its trading partners. It claims its policies in regards to economic cooperation with developing countries in Africa are guided by principles of sincerity, equality and mutual benefit, South-South solidarity and common development.

China unlike the West, supports the concentration of investment in infrastructure and human capital development and addressing development problems whose solutions cannot be offered by market oriented corporate initiatives. China has also proven willing to fund large scale projects.
for various African governments such as conference centers, stadia, monuments and similar projects that are not directly connected to economic development. In 2006 China put in motion another of its unique approaches to Africa when she held the China-Africa summit in Beijing and brought together 48 and out 53 African heads of states to discuss economic cooperation with China. This summit, the yearly high-level China-Africa ministerial conferences and China’s frequent granting of formal state visits to the leaders of individual recipient countries or when Chinese leaders pay high-level visits to such countries has paid lots of dividends for China. China is for example the biggest investor in such countries as Sudan whose leader Omar Al-Bashir of Sudan was recently accorded very high state honors during a state visit to China but cannot make similar visits to the West because he has been indicted by the International Criminal Court for alleged crimes against humanity in his country. China is also a major investor in Zimbabwe where the leadership has poor relations with the West in regards to alleged gross human rights violations. It is type of relations and its policy of non-interference in internal affairs of other countries that has earned China lots of criticism from the West. The fact however that is the policy puts China on an advantaged position in its relations with African states.

China’s approach to economic relations with countries in Africa is therefore different and appealing to cooperating states and explains China’s increasing influence in Africa. It is this increasing influence that is often on one hand criticized by the West and on the other hand welcomed by most African leaders. It is criticized as being a self-centred approach to secure natural resources, contracts, investment opportunities and markets while ignoring and even promoting poor governance and social problems such as human rights violations and corruption.20 This criticism is not supported by empirical evidence but if it is true that China has made political blunders in its policies towards several countries in Africa where bad governance

and human rights violations take place and deserves censure, so do some Western states which have made and continue to make or support economic and political errors in Africa. Irresponsible business or political behavior in Africa deserves criticism irrespective of which country is the perpetrator.

China and many cooperation partners in Africa have defended China-Africa relations by pointing out the many infrastructure, agricultural, technological, human capital development among other projects and investments that China is carrying out in various countries that the Western market oriented investors do not venture into. This study set out to investigate the authenticity in either point of view using empirical evidence on the effects of Chinese FDI in Kenya’s economy. Findings will enable an informed judgment on the activities of China in Kenya and given that China engages other countries using the same policies, may be true in the case of many other countries in the continent.

4.3 China’s Foreign Direct Investments in Kenya

According to statistics available from Kenya Investment Authority (KIA) the government’s agency charged with promoting Kenya as an investment destination and which assists foreign investors to set up their commercial activities in the country, there are about 100 Chinese companies that have been established in Kenya between 2000 and 2010 all employing about 10,000 Kenyans. A list of all Chinese investments registered in Kenya between 2000 and 2010 is attached to this study as Appendix 2. Based on data from the same agency, the value of FDI from China between 2000 and 2010 is estimated at more than US $ 970 million. There are

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32 Ibid
fourteen main sectors in which Chinese investors have invested in Kenya. An examination of the investments in each of these sectors reveals that Chinese FDIs are distributed over several sectors even though some sectors have received more capital investments than others.

Infrastructure development has apparently been the largest investments by China in the country. From statistics obtained from KIA several investments in this sector were completed before the study period but data shows that China has invested more than Ksh 40 billion on this sector between 2000 and 2010. These investments have been identified by the government of Kenya as key to attaining the objectives of the Vision 2030 and Chinese Companies have been awarded majority of the projects. This is because they are funded by China’s concessionary loans, and grants to the government of Kenya and Chinese firms are awarded the tenders as explained earlier. Some of the projects that have been completed by such Chinese firms as China Road and Bridge Construction Company, Wu Yi Company, Sichuan International Economic and Technological Cooperation Company, Jiangsu International Economic and Technological Cooperation Company among others include the construction of Kipsigak-Serem-Shamakhokho road at a cost of Ksh 500million, UNEP-JKIA road, large sections of Nairobi - Mombasa road, Lanet- Timboroa road among others. There are many ongoing infrastructural projects including the Nairobi Roads project, Gambogi- Serem road, renovation and expansion of Jomo Kenyatta International Airport runways and the renovation of Kasarani Sports Centre among others.

In 2010 China signed agreements with the government of Kenya to fund and undertake the following projects that are identified as key to attaining objectives of Vision 2030:

- Development of first three berths and associated infrastructure of Lamu Port at Manda Bay at a cost of US $1.5 billion;
- Development of a Railway Network from Lamu to South Sudan and

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33 Central Bank of Kenya 2010 Report
34 Ibid
Ethiopia at a cost of US$ 3.7 billion; Construction of a standard gauge railway from Mombasa to Malaba; Development of a mass Transit Light Rail system for the Nairobi Metropolitan area at a cost of US $ 900 million and the Development of the High Grand Falls Multipurpose Project on River Tana at a cost of US$ 947 million.\textsuperscript{35}

Statistics from Kenya Investment Authority show that investments by Chinese Companies in the Wholesale and Retail sector have been amongst the largest after investments in infrastructure. This reinforces the notion that Chinese investments are largely market seeking. Notable investors include Horizon Ivato Company and Greatland Pharmaceutical Limited who between them have invested more than Ksh 11 billion in the wholesale and retail of household and pharmaceutical products.\textsuperscript{36}

Investments in the Agricultural sector have also been notable. Investments by Beinparts Limited in Coffee growing in Ruiru, Chang Sheng International Limited in the growing and export of mushrooms and Mabokoni Ostrich investment have accounted for an estimated Ksh 8 billion of the total Chinese FDI. Of particular interest in this sector is that these investors produce specifically for the Chinese market.

Although investment outlays in the manufacturing sector are smaller in comparison with the sectors indicated above, statistics from the Kenya Investment Authority indicate that there are more Chinese manufacturing investors than in any other sectors all accounting for more than Ksh 7 billion worth of investments during the research period.\textsuperscript{37} Each year from 2000 to 2010, there have been Chinese manufacturers, processors and assemblers investing in Kenya. KIA data sets indicates examples including Crown Sea Enterprises and Neo-Smart Suppliers Limited in shoes production, China Victory King Stone Material Company in Ballast making, Tisco Kenya

\textsuperscript{35} Ibid
\textsuperscript{36} Derived from Kenya Investment Authority’s Data sets
\textsuperscript{37} Ibid
Limited in Bicycle manufacture. Double Leopard Enterprises in assembly of motorcycles, Youngstar International Limited in manufacture of mosquito nets, and several others in businesses ranging from manufacture of optical lenses, mattresses, motor vehicle batteries, glass and aluminum to processing of foodstuffs. There is indication that the products manufactured by these investors are largely meant for the local and regional market.

There have also been Chinese investors in modern technology oriented businesses and who account for more than Ksh 4 billion worth of investments. Investors include Sun Yu Limited in extraction of petroleum products from plastic wastes, Chang Heng Electronics in production of electronic goods and Africa-China International Limited in recycling of plastics among others. Although not classified as investments, Chinese firms have also been largely involved in the telecommunications sector. ZTE Corporation in 2010 signed a Ksh 4 billion contract with Telkom Kenya to establish the firm’s third generation (3G) network in the footsteps of another Chinese telecommunication firm Huawei which is involved in Safaricom’s fourth generation (4G) network establishment.38

Import and Export oriented investments have also accounted for huge investment outlays. Victory River Company Limited, Hgy International Company Limited, Dong Fang Development Limited, China Flying Dragon Kenya Limited are some of the companies involved in the export and import of a wide variety of goods. The large investment figures in this sector are also a pointer to the fact that most of these investors are just like those in the Wholesale and Retail businesses are market seeking for Chinese products to the Kenyan and East African market.

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In the automotive sector, several investors account for more than Ksh 2 billion worth of investments. Foton Motors has invested Ksh 1.2 billion in an assembly plant in Nairobi to produce prime movers, buses, light commercial trucks and pick-ups for the local and regional markets. Other investors in this sector include, Transafrica Motors Limited, Hua Long Company Limited, and Dong Fang Auto Assembly Company.

Chinese investments in the textiles sector are not as big as anticipated accounting for an estimated Ksh 590 million according to Kenya Investment Authority Statistics. Most of these investments are based in the Export Processing Zone and manufacture under bond under the AGOA arrangement. An-Ning Holding, Lulu Development and Stuttafords International Fashions Company Limited are some of the investors in the sector. The relatively small numbers of Chinese investors in the textile sector do not obviously account for the proliferation of Chinese clothing and textile products found in Kenya and therefore lead to the deduction that most of these products are imported directly from China by both Chinese and Kenyan importers.

Investments in Real Estate, Tourism, Services, Hospitality and Transport sectors have also been coming in and account for more than Ksh 3.6 billion worth of investments. Chengdu Guanling Kenya Company Limited is involved in real estate development in Kamiti and Mlolongo areas while Go Africa Travel Limited is listed as an investor in tourism, Fast Track Kenya Limited and Proparco East Africa Limited are investors in transport and grain handling respectively. Other investors are in the restaurant, medical and beauty sectors.

Table 4.1 below shows the values of Chinese FDI in Kenya in different sectors between 2000 and 2010.

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39 Derived from Kenya Investment Authority’s Data sets
40 Ibid
41 Ibid
### Table 4.1: Chinese FDI to Kenya by sectors 2000-2010

<table>
<thead>
<tr>
<th>Sector</th>
<th>Value (Ksh million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>6,994</td>
</tr>
<tr>
<td>Transportation</td>
<td>48</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>40,090</td>
</tr>
<tr>
<td>Restaurant</td>
<td>441</td>
</tr>
<tr>
<td>Technology</td>
<td>4,497</td>
</tr>
<tr>
<td>Textile</td>
<td>598</td>
</tr>
<tr>
<td>Real Estate</td>
<td>2,400</td>
</tr>
<tr>
<td>Automotive</td>
<td>2,540</td>
</tr>
<tr>
<td>Import and Export</td>
<td>4,148</td>
</tr>
<tr>
<td>Agricultural</td>
<td>8,170</td>
</tr>
<tr>
<td>Services</td>
<td>574</td>
</tr>
<tr>
<td>Wholesale and Retail</td>
<td>11,370</td>
</tr>
<tr>
<td>Tourism</td>
<td>627</td>
</tr>
<tr>
<td>Resource Exploration and Extraction</td>
<td>4,125</td>
</tr>
<tr>
<td>TOTAL</td>
<td>86,622</td>
</tr>
</tbody>
</table>

Source: Author (2011)

#### 4.4 Impact of Chinese FDI in Kenya

To analyze the impact of Chinese FDI in Kenya's economy, primary data was collected. A total of 100 questionnaires were distributed to respondents in relevant Government Ministries and agencies, to local and foreign businesspeople and respondents in selected corporate organizations in Nairobi. Respondents from the Ministry of Finance were identified since the
Ministry is the one that administers and monitors all grants, loans and any other monetary inflows including investments into the country from all development partners including China. Respondents were also identified from the Trade and Commerce section and the China Desk of the Ministries of Foreign Affairs and Trade and Industry respectively. These two Ministries work closely in promoting Kenya's trading and investment ties with other countries. Two specialist government agencies the Kenya Investment Authority and the Export Promotion Council were also approached for respondents because their mandates include promoting Kenya as an investment destination and assisting Kenya's exporters to identify external markets. Questionnaires were also distributed to manufacturers in the Export Processing Zone, local wholesale and retail businesspeople whose businesses deal in exports to Chinese markets or import Chinese products for sale in Kenya or are in direct competition with Chinese businesses in Kenya. Respondents from the corporate sector were important in that Chinese technology is increasingly being used by Kenyan firms.

Out of 100 questionnaires circulated 78 questionnaires were returned out of which 72 were fully completed. This makes a response rate of 72 percent which conforms to the requirement that while a response rate of over 50 percent is adequate for analysis a response rate of 70 percent or over is very good. The data received from the respondents is represented hereunder in the following tables.

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42 Mugenda O, & A Mugenda, *Research Methods, Quantitative and Qualitative Approaches*, (Nairobi, ACTS Press, 1999)
Table 4.2: Respondents' level of education

<table>
<thead>
<tr>
<th></th>
<th>Frequency of Respondents</th>
<th>Percentage representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diploma/ HND</td>
<td>21</td>
<td>29.2</td>
</tr>
<tr>
<td>Other College Education</td>
<td>20</td>
<td>27.8</td>
</tr>
<tr>
<td>Degree</td>
<td>28</td>
<td>38.9</td>
</tr>
<tr>
<td>Postgraduate/PhD</td>
<td>3</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>72</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: Author (2011)

The study first sought to establish the respondents' level of education. According to the findings, nearly half of respondents had a basic or advanced degree as shown by 43% of the respondents. 57% of the respondents were also fairly well educated at college level. This shows that most of the respondents were well educated and could understand and respond competently to the questions and issues raised in the study.

Table 4.3: Categories of the respondents

<table>
<thead>
<tr>
<th></th>
<th>Frequency of Respondents</th>
<th>Percentage representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local business person</td>
<td>24</td>
<td>33.3</td>
</tr>
<tr>
<td>Foreign business person</td>
<td>15</td>
<td>20.8</td>
</tr>
<tr>
<td>Government representative</td>
<td>20</td>
<td>27.7</td>
</tr>
<tr>
<td>Corporate sector</td>
<td>13</td>
<td>18.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>72</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: Author (2011)
From the returned questionnaires, 33.3% of the respondents were local business people, 27.7% respondents in Government Ministries and agencies while respondents from foreign businesses and from the corporate sector comprised 20.8% and 18% respectively.

Table 4.4: Whether Foreign Direct Investments is perceived important for the economic growth of Kenya

<table>
<thead>
<tr>
<th>Frequency of Respondents</th>
<th>Percentage representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>70</td>
</tr>
<tr>
<td>No</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>72</td>
</tr>
</tbody>
</table>

Source: Author (2011)

The study found that the majority of the respondents at 97.2% perceived that Foreign Direct Investments are an important requirement for the economic growth of Kenya while 2.8% of the respondents thought otherwise.

Table 4.5: Whether the country’s investment policies encourage adequate foreign investments to the country

<table>
<thead>
<tr>
<th>Frequency of Respondents</th>
<th>Percentage representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>39</td>
</tr>
<tr>
<td>No</td>
<td>33</td>
</tr>
<tr>
<td>Total</td>
<td>72</td>
</tr>
</tbody>
</table>

Source: Author (2011)
54.2% of the respondents were in agreement that the country’s investment policies encourage foreign investments to the country while 45.8% of the respondents differed with this. The respondents who were in agreement noted that the government’s incentive policy and legal framework provides ample incentive for foreign direct investment and that the new constitution has put in place measures that encourages fairness in investment, less bureaucracy and policies which include private public partnership approach which should further make Kenya a more attractive investment destination. The respondents in disagreement however pointed out Kenya’s high taxation rates as hindering investments and that the country’s investment climate is often hindered by unfavourable politically driven policies.

Table 4.6: Whether the country should change the traditional Western oriented economic ties and cultivate stronger economic relations with Asian countries such as China

<table>
<thead>
<tr>
<th></th>
<th>Frequency of Respondents</th>
<th>Percentage representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>57</td>
<td>79.2</td>
</tr>
<tr>
<td>No</td>
<td>15</td>
<td>20.8</td>
</tr>
<tr>
<td>Total</td>
<td>72</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Author (2011)

Given that Kenya has traditionally received investments and development assistance from the West, the respondents were requested to indicate whether they believe the country should change this orientation and cultivate stronger economic relations with Asian countries such as China. From the responses, the majority of the respondents (79.2%) were in agreement while a small proportion of the respondents (20.8%) differed. The respondents in agreement noted that diversified sources of FDI are good for the country as it is a faster path to economic
independence in the future. The respondents noted that China has grown fast economically and technologically and due to low costs of production, their products are cheap and easily available. The respondents also equated Western development partners’ conditionalities tied to development assistance to neo-colonialism that increases the country’s debt burden and compares poorly to China’s development assistance which is given with less conditionalities. Others were of the idea that as a Third World country, Kenya needs investment from both sides for faster economic growth and that country should open up or diversity the sources of FDI and export markets for its products and services while inviting more investments from such countries as Japan which is very advanced technologically.

Table 4.7: Whether the increased economic cooperation between Kenya and China will enable Kenya to attain faster economic growth

<table>
<thead>
<tr>
<th></th>
<th>Frequency of Respondents</th>
<th>Percentage representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>68</td>
<td>94.4</td>
</tr>
<tr>
<td>No</td>
<td>4</td>
<td>5.6</td>
</tr>
<tr>
<td>Total</td>
<td>72</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Author (2011)

The study wanted to establish the respondents’ perception on whether the increased economic cooperation between Kenya and China will enable Kenya to attain faster economic growth. According to the findings, a large 94.4% of the respondents felt that the increased economic cooperation between Kenya and China will enable Kenya to attain faster economic growth while a small proportion (5.6%) of the respondents thought otherwise. The respondents noted that the increased economic cooperation between Kenya and China will enable Kenya to attain faster economic growth through technological transfers which will enable Kenya to be technologically
self-reliant in the future. They noted that China’s cheap imports are affordable by majority of Kenyans and that their manufacturing investments create jobs opportunities and transfers technical knowhow while infrastructural investments will spur economic development both in the urban and the rural areas.

Table 4.8: Extent that Chinese economic cooperation including investments affects the economic growth of Kenya

<table>
<thead>
<tr>
<th>Frequency of Responses</th>
<th>Percentage representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>27</td>
</tr>
<tr>
<td>Great extent</td>
<td>29</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>12</td>
</tr>
<tr>
<td>Little extent</td>
<td>2</td>
</tr>
<tr>
<td>Very little extent</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>72</td>
</tr>
</tbody>
</table>

Source: Author (2011)

Related to the preceding question, respondents were requested to indicate the extent to which they thought that Chinese economic cooperation including investments affects the economic growth of Kenya. According to the responses given, 37.5% of the respondents reported that it affects the economic growth of Kenya to a very great extent, 40.3% said to a great extent, 16.7% put it at moderate extent while those who felt that Chinese economic cooperation including investments affects the economic growth of Kenya to a little extent and to a very little extent
were represented by a 2.8% in each case.

Table 4.9: Sectors of the Kenyan economy that more Chinese investments can result in faster and sustainable economic growth

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Frequency of Responses</th>
<th>Percentage representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>11</td>
<td>15.3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>41</td>
<td>56.9</td>
</tr>
<tr>
<td>Services</td>
<td>20</td>
<td>27.8</td>
</tr>
<tr>
<td>Total</td>
<td>72</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Author (2011)

56.9% of the respondents reported that more Chinese investments in manufacturing can result in faster and sustainable economic growth while 27.8% and 15.3% felt that it was the Services and the Agriculture sectors that should receive more investments respectively.

Table 4.10: Extent that various factors influence the inflow of Chinese FDIs in Kenya economy

<table>
<thead>
<tr>
<th>Factors</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government's investment framework lays out many incentives to investors</td>
<td>2.7500</td>
<td>1.31888</td>
</tr>
<tr>
<td>Availability of relatively well educated and skilled workforce</td>
<td>3.4861</td>
<td>1.18670</td>
</tr>
<tr>
<td>China's search for new energy and raw material sources to fuel its fast growing economy</td>
<td>3.2778</td>
<td>1.42633</td>
</tr>
<tr>
<td>China is using Kenya as an entry point to the East African region</td>
<td>3.6250</td>
<td>1.28301</td>
</tr>
<tr>
<td>Political stability in Kenya ensures safety of the foreign firms' operations</td>
<td>3.0556</td>
<td>1.66901</td>
</tr>
</tbody>
</table>

Source: Author (2011)
On the extent that various factors influence the inflow of Chinese FDIs into the Kenyan economy, majority of the respondents indicated that to a great extent, China is using Kenya as an entry point to the East African region as shown by a mean score of 3.6250. The respondents also indicated that the availability of a relatively well educated and skilled workforce as shown by a mean score of 3.4861 also influences the inflow of Chinese FDIs to a moderate extent. Other influencing factors including China’s search for new energy and raw material sources to fuel its fast growing economy, political stability in Kenya and the incentives in the government’s investment framework were ranked lower as shown by a mean scores of 3.2778, 3.0556 and 2.7500 respectively.

Table 4.11: Extent of agreement on the impact of Chinese foreign investment in Kenyan economy

<table>
<thead>
<tr>
<th>Extent of Agreement</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>China’s involvement in building and upgrading infrastructural facilities will put</td>
<td>3.5833</td>
<td>.85168</td>
</tr>
<tr>
<td>Kenya back on faster economic development path.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chinese investors offer simple technology that can easily be learnt and copied by</td>
<td>3.2500</td>
<td>.74588</td>
</tr>
<tr>
<td>Kenyans to improve productivity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kenyans can benefit much from Chinese work ethics and managerial styles</td>
<td>3.1806</td>
<td>.89327</td>
</tr>
<tr>
<td>Chinese investments should be encouraged because the government gains tax revenues</td>
<td>3.0000</td>
<td>.91928</td>
</tr>
<tr>
<td>There has been increased growth in merchandize and services trade between the two</td>
<td>3.1528</td>
<td>.79894</td>
</tr>
<tr>
<td>countries through Chinese investments in Kenya</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Chinese investors create competition for local producers and retailers and is healthy for the economy.

<table>
<thead>
<tr>
<th></th>
<th>2.8333</th>
<th>1.07468</th>
</tr>
</thead>
</table>

The government should take measures to ensure Chinese investors do not flood Kenyan market with cheap and poor quality products.

<table>
<thead>
<tr>
<th></th>
<th>3.5556</th>
<th>.74850</th>
</tr>
</thead>
</table>

Chinese investors are contributing greatly to employment creation in the country

<table>
<thead>
<tr>
<th></th>
<th>3.1389</th>
<th>.96860</th>
</tr>
</thead>
</table>

Chinese investors easily create linkages with local suppliers and subcontractors

<table>
<thead>
<tr>
<th></th>
<th>2.7778</th>
<th>.92268</th>
</tr>
</thead>
</table>

Whereas Kenya has opened up to Chinese investors and trade, Kenya businessmen have difficulties in accessing Chinese markets. This imbalance should be addressed.

<table>
<thead>
<tr>
<th></th>
<th>3.1111</th>
<th>1.08193</th>
</tr>
</thead>
</table>

Source: Author (2011)

The respondents were requested to indicate the extent to which they agreed with indicators of the positive impact of Chinese foreign investment in Kenya's economy. According to the responses, the majority of respondents indicated that to a great extent China's involvement in building and upgrading infrastructural facilities will put Kenya back on faster economic development path as shown by a mean score of 3.5833 and that Chinese investors may flood Kenyan market with cheap and poor quality products against which the Kenyan government should take measures to control as shown by a mean score of 3.5556.

The respondents were also in agreement that to a moderate extent, Chinese investors offer simple technology that can easily be learnt and copied by Kenyans to improve productivity as shown by a mean of 3.2500. That Kenyans can benefit much from Chinese work ethics and
managerial styles was also agreed to as indicated by a high mean score of 3.1806, with respondents also agreeing that there has been an increased growth in merchandize and services trade between the two countries through Chinese investments in Kenya as shown by a mean score of 3.1528. That Chinese investors are contributing greatly to employment creation in the country also got a good number of respondents in agreement as shown by a mean score of 3.1389. Respondents were also concurred on the lop-sided nature of cooperation between the two countries that whereas Kenya has opened up to Chinese investors and trade, Kenya businessmen have difficulties in accessing Chinese markets and that this imbalance should be addressed as shown by a mean score of 3.1111. Respondents were also in agreement with the statement that Chinese investments should be encouraged because the government gains tax revenues as shown by a mean score of 3.0000 but were less in agreement that Chinese investors create competition for local producers and retailers and that this is healthy for the economy as shown by a mean score of 2.8333 and that Chinese investors easily create linkages with local suppliers and subcontractors as shown by a mean score of 2.7778.

The respondents indicated that the negative aspects of Chinese investments in Kenya that should be addressed include the possibility of flooding Kenya market with cheap and low quality products, investments that do not support backward linkages in the economy and do not encourage transfer of know-how. Respondents also indicated environmental pollution concerns and in particular the disposal of Chinese originated electronic waste.
Table 4.12: Factors that hinder inflows and contribution of Chinese FDIs on the growth of Kenya’s economy

<table>
<thead>
<tr>
<th>Factors</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>The bureaucratic requirements that makes establishment of business</td>
<td>3.7639</td>
<td>1.11952</td>
</tr>
<tr>
<td>in Kenya lengthy and cumbersome</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The high cost of energy</td>
<td>4.0972</td>
<td>1.06361</td>
</tr>
<tr>
<td>Level of corruption in the public sector</td>
<td>4.0556</td>
<td>1.03310</td>
</tr>
<tr>
<td>The high minimum capital investment required of foreign investors</td>
<td>3.6667</td>
<td>1.15063</td>
</tr>
<tr>
<td>The Government of Kenya’s apparent slow progress on political and</td>
<td>3.6111</td>
<td>1.19336</td>
</tr>
<tr>
<td>economic reforms</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Restrictions on land acquisition by foreigners</td>
<td>3.3056</td>
<td>1.33890</td>
</tr>
<tr>
<td>Government of Kenya's slow progress in addressing and educating</td>
<td>3.6944</td>
<td>1.14620</td>
</tr>
<tr>
<td>local populations opposed to proposed foreign investments in their</td>
<td></td>
<td></td>
</tr>
<tr>
<td>areas e.g. The Tiomin mining venture in Kwale and the proposed port in</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lamu</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The lack of a Bilateral Investment Treaty between Kenya and China</td>
<td>3.2083</td>
<td>1.26644</td>
</tr>
<tr>
<td>Socio-cultural beliefs about some foreign products</td>
<td>3.1667</td>
<td>1.37380</td>
</tr>
<tr>
<td>Environmental considerations</td>
<td>2.9028</td>
<td>2.05666</td>
</tr>
</tbody>
</table>

Source: Author (2011)

The study wanted to establish the extent to which various factors hinder inflow and contribution of Chinese FDIs on the growth of the county economy. From the findings, majority of respondents reported that the factors that hinder inflow and contribution of Chinese FDIs on the
growth of the county economy to a great extent include the high cost of energy, level of corruption in the public sector and the bureaucratic requirements that makes establishment of business in Kenya lengthy and cumbersome as shown by a mean scores of 4.0972, 4.0556 and 3.7639 respectively. The government of Kenya's slow progress in addressing and educating local populations opposed to proposed foreign investments in their areas e.g. The Tiomin mining venture in Kwale and the proposed port in Lamu, the high minimum capital investment required of foreign investors and the Government of Kenya's apparent slow progress on political and economic reforms were also rated high as impediments as shown by mean scores of 3.6944, 3.6667 and 3.6111 respectively.

The factors that were rated moderate in hindering inflow and contribution of Chinese FDIs on the growth of the economy include restrictions on land acquisition by foreigners, the lack of a Bilateral Investment Treaty between Kenya and China and socio-cultural beliefs about some foreign products as shown by mean scores of 3.3056, 3.2083 and 3.1667 respectively. Environmental considerations were ranked lowest in impeding FDI inflows as shown by a mean score of 2.9028.

Table 4.13: Rank of possible contribution of Chinese FDI to growth in Kenya economy

<table>
<thead>
<tr>
<th>Contribution to Kenya’s economy</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Injection of Capital and providing tax revenue to the government</td>
<td>3.5278</td>
<td>.78672</td>
</tr>
<tr>
<td>Creation of employment and linkages with local businesses</td>
<td>2.7778</td>
<td>1.02397</td>
</tr>
<tr>
<td>Diversification of Kenya's exports products and destinations</td>
<td>2.6250</td>
<td>.97052</td>
</tr>
<tr>
<td>Transfer of modern technology to various sectors of the economy</td>
<td>2.8333</td>
<td>1.18678</td>
</tr>
</tbody>
</table>

Source: Author (2011)
The respondents were also requested to rank in order of what they thought was more important of the possible contributions of Chinese FDI to growth in Kenya economy and injection of capital resources and provision of tax revenue to the government, transfer of technology, creation of employment and diversification of exports and destinations were ranked in this order as indicated by the means scores indicated in the table above.

The study finally sought to establish the extent to which respondents agree with sentiments against or in support of increased Chinese economic and political cooperation with African countries. According to the findings in the table below, majority of the respondents were in agreement that Africa has a lot to learn from China's rapid economic growth as shown by a mean score of 3.3056. Respondents also agreed with the likelihood that China will flood African markets with their relatively cheap products and foster the decline of local manufacturing as shown by a mean score of 3.2778, and that China's cooperation with African economies is healthy and relieves African economies from impractical Western originated economic models as shown by a mean score of 3.2639. That China's cooperation and assistance to poor countries in Africa helps to balance global power and allows less dependence on America and Europe was also rated highly as shown by a mean score of 3.2083. The respondents were also in agreement that although China helps African countries development goals through concessional loans and grants without much conditionalities, it increases Africa's debt burden as shown by a mean score of 3.1528 and that China's policy of non-interference in the politics of African countries perpetuates poor governance and human rights violation as shown by a mean score of 3.0972. Respondents were less in agreement that the simplicity and affordability of Chinese technology and imports will help to alleviate poverty in Africa and that China's demand for African oil and other raw materials helps to increase Africa's over reliance on primary exports as shown by mean
scores of 3.0833 and 2.7083 respectively.

Table 4.14: Level of agreement with sentiments against or in support of increased Chinese economic and political cooperation with Kenya and other African countries

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>China's cooperation with African economies is healthy and relieves African economies from impractical Western originated economic models</td>
<td>3.2639</td>
<td>.76900</td>
</tr>
<tr>
<td>China's demand for African oil and other raw materials helps to increase Africa's over reliance on primary exports</td>
<td>2.7083</td>
<td>.79501</td>
</tr>
<tr>
<td>China will flood African markets with cheap products and foster the decline of local manufacturing</td>
<td>3.2778</td>
<td>.90728</td>
</tr>
<tr>
<td>China's policy of non-interference in the politics of African countries perpetuates poor governance and human rights violation</td>
<td>3.0972</td>
<td>1.16474</td>
</tr>
<tr>
<td>The simplicity and affordability of Chinese technology and imports will help to alleviate poverty in Africa</td>
<td>3.0833</td>
<td>.97504</td>
</tr>
<tr>
<td>Although China helps African countries development goals through loans and grants without much conditionalities, it increases Africa's debt burden</td>
<td>3.1528</td>
<td>.83345</td>
</tr>
<tr>
<td>China's cooperation and assistance to poor countries in Africa helps to balance global power and allows less dependence on America and Europe</td>
<td>3.2083</td>
<td>.91832</td>
</tr>
<tr>
<td>China's rapid economic growth provides learning opportunities for Africa on growth model</td>
<td>3.3056</td>
<td>.83310</td>
</tr>
</tbody>
</table>

Source: Author (2011)

4.5 Conclusion

Kenya’s performance as a FDI destination has been poor and below the country’s actual potential. The country’s high cost of doing business has among other reasons been blamed for this performance. Although the government has in the recent past sought to be more
economically self-supporting with less dependence on foreign capital and aid for budgetary and
development support, it has identified foreign investments and concessional finance as being key
to attaining the objectives of the Kenya Vision 2030.

China's economic cooperation with Kenya although dating back to the latter's independence in
1963 has increased significantly over the last ten years. The increased cooperation stems from
Kenya's decision since 1990s to diversify its sources of investment and development assistance
and largely due to China's change in economic orientation that resulted in massive economic
growth that has necessitated it to seek new sources of raw material and markets in Africa.
Although FDI inflows to Kenya from China are low in comparison with Kenya's traditional
investment partners, China's has over the last ten years become one of Kenya's top investment
and development sources in addition to a rapidly rising trading partner portfolio. It is China's
increasing influence in Africa and the resultant unease in the developed world that gave the idea
for this study.

China's development assistance and investments in Kenya have been rising rapidly because of
China's unique model of cooperating with African economies. The government of China
packages development assistance and investments in a manner that is attractive for Kenya's and
similar economies' development strategies. China's concessional loans and grants for capital
investment programmes are used to fund projects often awarded to Chinese companies who often
complete these projects on time and at relatively lower costs. Private Chinese investors also find
it easier to invest in such countries as Kenya because of financial and insurance support from
their government. Between 2000 and 2010, about 100 Chinese companies have been established
in Kenya according to government statistics. A large of these companies are involved in
manufacturing but there are others in motor vehicle assembly, import and export, wholesale and
retail, tourism, real estate, restaurants, agriculture, telecommunications, textile and construction and civil engineering. Statistical data however indicates that road construction and civil engineering have had the largest investment outlays.

Given the increased investments and general economic cooperation between China and Kenya, the study sought to analyze the impact of China’s investments through investigation of the perceptions of Government officials in relevant Ministries and agencies, businesspeople and members of selected corporate organizations on these investments. The findings, conclusions and recommendations derived from the investigations will be discussed in the next Chapter.
CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This study set out to identify the types of Chinese FDI in Kenya during the period 2000 to 2010, their impacts on the Kenyan economy and to examine their implications on the relations between Kenya and China. China’s growing economic and political influence in Africa is a subject that has attracted a lot of discourse and it is the varying sentiments as what the increasing economic and political influence of China in the continent portends for the economic growth ambitions of a developing country such as Kenya that piqued the interest for the subject and hence this study. China’s remarkable economic growth has necessitated its cultivation of closer ties with other countries especially in Africa.¹

China’s approach to political and economic cooperation with Africa contrasts with that of Africa’s traditional development partners in the West who due to economic and political changes brought about by the effects of globalization and integration have increasingly reduced their governments’ and multinational corporations’ stakes in Africa.² China explains its policies and relations with African countries as being guided by principles of sincerity, equality and mutual benefit, South-South solidarity and common development and the policy of non-interference in the internal affairs of its trading partners. For under developed countries in Africa whose economic and even political relations with the West have been included periods of, colonialism, structural adjustment programmes and economic growth models that have not worked an alternative development partner was most welcome. These are the factors that endear China to

² Davies M, ‘How China is Influencing Africa’s Development’ OECD Development Centre-Perspectives on Global Development 2010 op cit., pp.18-25
African countries who for long have had unequal has made it one of the leading trading, investment and development partner for many countries in the continent including Kenya in the last two decades. This has drawn skepticism and criticism particularly from the West in regards to China’s underlying motives. It is against this background that this study sought to examine China’s FDI in Kenya and whether their impacts support or negate the criticism labeled against Chinese economic cooperation with African economies and Kenya in particular.

The study also examined FDI and its theoretical relation to economic growth. The conclusion drawn is that there is theoretical economic sense for a developing economy to attract as much FDI as possible due to its ability to bring into the economy new capital that augments domestic savings, introduce new forms of technology that replaces or enhances existing ones and create positive linkages for local production, export promotion and employment creation. Despite the benefits of FDI, it was noted that they come with costs and that a country must develop strategies and the absorptive capacity so as to be able to seize the advantages and avoid the potential negative outcomes.

The study then narrowed the discussion to FDI in Kenya. It was noted that between 1980 and 2001, despite its economic potential, Kenya lost its competitiveness in attracting new investments and retaining existing ones particularly from the West. The reasons for this were identified as rising from perception by investors in regards to governance, corruption, poor infrastructure and insecurity. Since 2002, despite such efforts as tackling corruption through the Kenya Anti Corruption Commission and changes in leadership foreign investments are still

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not coming in desired numbers and the unfavourable sections of the country’s investment policy framework and the high cost of doing business in Kenya in comparison with neighbouring countries are cited as impediments. Internal challenges are not the only reasons why Western investors have not been increasing their presence in Kenya or are relocating from the country. Recent global economic factors have necessitated some multinational corporations to realign their strategies and relocate to bigger economies in Africa and other continents. This period coincided with China’s rapid economic advancement and the two countries due to different but mutually complementing economic strategies have nurtured close relations since 2002 that has resulted in China currently being among Kenya’s key development, investment and trading partner. Given China’s current involvement in development and investment programs in Kenya in line with the objectives of the Vision 2030 economic strategy, there is the possibility of increased China’s economic influence in the country in the future.

Finally the study examined Kenya’s relations with China since independence and noted that apart from a break in relations in the 1970s, the two countries have generally enjoyed cordial relations. Increased economic cooperation started in the 1990s and was further enhanced in the last two decades. Investment flows have increased since 2000 to currently rank China among the top sources of FDI to Kenya with total investment stocks of an estimated US$ 970 million.

5.2 Key Findings

The study found that Chinese FDIs are spread out among different sub-sectors of the manufacturing, services and agriculture sectors of the Kenyan economy. According to data from

Kenya Investment Authority (KIA) it was found that during the study period, one hundred Chinese investment companies were registered to carry out businesses in Kenya. Of these, forty percent were in services related investments. These investments were made up of eighteen companies in Import and Export of a wide variety of commodities, six in Hospitality, six in Wholesale and Retail of different commodities, six in Tourism, Digital television services and Rural electrification and two each in Transport and Medical related services. Thirty-nine percent of the investments are found in manufacturing related investments with twenty three companies manufacturing a wide variety of products, eleven in assembly of motor vehicles and motorcycles and five companies in food processing. There are smaller numbers of Chinese investments in other forms of investments making up the remaining twenty one percent. These include seven percent in technology related investments, five percent in construction and civil engineering investments, 3 percent in Agricultural investments and two percent each in Real Estate, Textile and Resource Exploration and Extraction. It was also found that Chinese investments in Kenya are mostly fully and privately owned by Chinese companies with very limited joint ownership or local capital.

The study also sought to investigate the impacts of Chinese in the country during the study period. These impacts were investigated against the theoretical linkages of FDI and economic growth which includes bringing into an economy new capital, technological, managerial and entrepreneurial transfers, productivity and export spillovers, and creation of employment.

The study found that against each of these parameters, there are gains and losses from Chinese FDI on the economy of Kenya. The Chinese infrastructural investments offer the biggest gains

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1 See Appendix 1  
2 See Chapter Four pp 92-95  
3 Ibid  
4 Ibid
for Kenya’s economy now and in the future. One of the reasons that Kenya underperformed as a FDI destination in the past was due to the poor state of infrastructure and in particular roads that increased the costs of transportation for investors and meant that investors were not motivated to invest in rural areas.\footnote{United Nations, ‘An Investment Guide to Kenya: Opportunities and Conditions ‘( New York and Geneva, United Nations 2007)} Statistics indicate that China has invested more than Ksh 40 billion on roads projects in the country. The roads networks that have been completed in Nairobi and upcountry in the last ten years have huge multiplier effects on all sectors of the economy. The numerous infrastructural projects currently being undertaken or planned to start in the near future by China in the country including among others the upgrade of the Jomo Kenyatta International Airport, roads projects in Nairobi, building of standard gauge railway from Mombasa to Malaba and from Lamu to Ethiopia and South Sudan, construction of a second port in Lamu, development of a mass Transit Light Rail system for the Nairobi Metropolitan area and the hydro and geothermal electricity generation projects all involve massive capital investments of an estimated US $ 8 billion that the Government of Kenya cannot afford within its economic limitations. These projects are in line with the objectives of the Vision 2030 and their impacts will undoubtedly be great for the economy but can only be assessed upon their completions.

However, the gains that Kenya gets from China’s capital investments in these infrastructural projects come with costs. Most of these projects are financed using concessionary loans and/or grants from the Peoples Republic of China which in turn requires that their contracting companies be awarded the contracts.\footnote{Holjag J, China’s FDI in sub-Sahara Africa, ( Brussels, Brussels Institute of Contemporary China Studies, 2008)} China claims that its contractors complete the projects on time and at lower costs and that this arrangement removes the opportunities for corrupt award of projects by Kenyan government officials. Although some aspects of these claims may be true
given Kenya’s past record of corruption where local and international contractors had to give kickbacks to government officials and ended up building poor quality roads at high costs and not completing them on time, due to the fact that such deals are unofficial the claims cannot be backed by statistical evidence. The downside of this form of arrangement however remains that competent local or international non-Chinese contractors are not given the chance for competitive bidding for the projects.

Another disadvantage that comes with Chinese infrastructural projects is that there are very limited technological transfers involved. Chinese contractors bring their own engineers for the projects and given the language barriers, employ Kenyans for unskilled or low level skill jobs such as plant operations, truck driving and manual labour. This together with the fact that Chinese contractors do not undertake joint contracts with local contractors means that their civil engineering technologies are not transferred and that there are no local contractors who can be used to maintain the infrastructures once they leave.

Another point of concern in regards to the infrastructural investments that China is financing and carrying out in Kenya is the likelihood of Kenya is getting into unsustainable debt. China through its China Export and Import and China Development banks allow for an approach where capital is invested in a manner that is suited for the development needs of Kenya. China does this in the case of many other countries in the continent as well. Concessional loans are extended for infrastructural projects and are used for procuring equipment, materials, technology and services with no less than 50 percent of the contract’s procurements coming from China. The loan is denominated in Chinese Renminbi (RMB) and has a maximum maturity period of 20

Davies M, ‘How China is Influencing Africa’s Development’ OECD Development Centre-Perspectives on Global Development 2010 op cit., pp 18-25
A grace period of 3-7 years may be granted, during which the borrower will only repay interest payments and not the principal. The interest rate is subsidized and underwritten by Chinese Government finances. To reduce the starkness of this very profitable commercial arrangement China regularly includes in the concessional finance packages, an aid component. China's projects that have been completed over the last five years, those that are ongoing and those which it's entered into bilateral agreements with the government of Kenya to undertake are estimated at more than US$ 9 billion. In oil and mineral resource rich countries such as Sudan, Angola and Democratic Republic of Congo, China undertakes infrastructural projects in exchange for the resources. Kenya does not have any of such resources and while a Chinese company the China National Offshore Oil Company has been awarded oil prospecting rights in Northern Kenya, it is not certain whether viable deposits will be discovered for which Kenya will exchange for the current and future concession loans. Kenya's current national debt stands at Ksh 1,281.71 billion and which translates to 54.9 percent of Gross National Product (GDP) is already high, and may grow higher given the country's requirements for more development funds to finance development projects in line with Vision 2030 objectives. The problem therefore is whether sustainable economic development can achieved without Kenya getting into unsustainable debt levels.

The impact of Chinese FDIs in regards to technological and skills transfers to the Kenya's economy was investigated against their manufacturing FDIs which offer the greatest means for

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14 Ibid  
16 Ibid  
17 Davies M, ‘How China is Influencing Africa’s Development’ OECD Development Centre-Perspectives on Global Development 2010 op cit., pp.18-25  
transferring Chinese technology to the country. Findings indicate that the investments are not big enough to ensure technological transfers that Kenyans can use in local industrial take-off. Most Chinese manufacturers are involved in the production of consumer goods such as shoes, candles, cigarettes, glass, car batteries and food processing among others the technology for which is already available in Kenya. Chinese investments in the motor vehicle industry are also not large enough and are only concentrated in the assembly of motor vehicles and motorcycles and hence has no translated into tangible transfers of technology that can change Kenya’s current industrialization status. China has excelled in the textile industry and in agricultural production. The study however found that investments in the two sectors are small. In textiles there are only two Chinese investors who manufacture under bond for the AGOA market. The firms do not have local partnerships and unfortunately do not have linkages with local cotton farmers and clothing material producers because the import their material requirements from China and India. In agriculture there are three Chinese investment companies who are engaged in production of coffee, mushrooms and rear ostriches for the Chinese market. Technological transfers are thus minimum in these two sectors.

As regards employment creation, Chinese investors employ directly an estimated ten thousand local workforce and more than one thousand Chinese. Apart from the roads construction and civil engineering companies each of which employs more than five hundred local workforces for the duration of the contracts, the majority of Chinese investments are small in size and employ less than fifty Kenyans. Despite the low direct employment figures for Kenyans, the greatest impact that Chinese investments have contributed is the creation of self-employment for a large section of Kenyans in the informal sector. The assembly of motorcycles in the country by

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19 Kenya Investment Authority, Chinese FDI in Kenya Data sets (Nairobi, 2011)
Chinese companies has brought down the prices of 100cc-200cc motorcycles to between Ksh 60,000 and Ksh 85,000. With estimated sales of over 350,000 motorcycles over the last 10 years most of which are employed in motorcycle taxi business, this translate to employment creation and income generation for more than 300,000 Kenyans.

Against FDIs ability to result in export diversification of the host country, a look at the number of Chinese FDIs in imports and exports and a scrutiny of the nature of their businesses indicates that most of these companies largely import Chinese goods into Kenya. Kenya’s exports to China in 2000 and 2010 were valued at Ksh 317 million and Ksh 2.7 billion respectively. This was an increase of 85 percent. Chinese imports on the other hand were valued at Ksh 7.7 billion in 2000 and Ksh 79 billion in 2010 showing an increase of 1,025 percent. The top ten Kenyan exports to China include; Non-ferrous base metal and scrap and copper, Vegetable textile fibres, Leather, Hides and Skins, Fruits and Nuts, Coffee and Tea, Crude vegetables, Fresh, frozen or chilled fish, Oil seeds and Soda ash. This list serves to indicate that Kenya still exports primary products to China with very little value addition. The link between Chinese FDI and promotion of Kenyan exports through value addition is therefore minimal and instead serve the reverse purpose of promoting Chinese imports. Kenya’s principal export to China, non-ferrous metals scrap and copper although earning the country foreign exchange has in some instances served to promote negative business practices in which unscrupulous Kenyan scrap metal dealers despite law enforcement agencies efforts to stop the vice, engage in the theft, vandalism and smelting of

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20 Business Daily, May 15, 2010

21 Ibid

electricity and communication cables that have created big losses for telecommunications and power companies and their clients.23

In regards to FDI creating beneficial backward linkages with local producers Chinese FDI are also found to offer mixed impacts. It has been explained above that Chinese road construction and civil engineering and textile companies mostly source their equipments and materials from China. This is negative particularly for the textile industry because Kenyan cotton farmers are not getting new markets for their produce and given the proliferation of cheap imported Chinese textile products in Kenyan markets, local textile producers such as Rivatex and Raymonds among others have due to high costs of production and competition closed down resulting in losses of employment for their workers and cotton farmers. The proliferation of many other Chinese consumer goods imported into the country by Chinese and Kenyan importers for example dry cell torch batteries although benefiting Kenyans seeking cheap products has led to competition to local manufacturer Eveready which in 2008 downsized its workforce due to reduced profits.24

5.3 Conclusion

From the findings this study leads to the conclusion that firstly, Chinese FDI in Kenya are driven to the largest extent by the motive of seeking markets. The manufacturing, automotive assembly, import and exports, wholesale and retail, textile, technological, transport, real estate and several service oriented investments all lead to the conclusion that Chinese investors are seeking to establish a strong presence in Kenyan market as an entry point to the larger East African market. The market seeking motive is stronger in Kenya than in other mineral resource rich countries in

23 Business Daily October 20, 2010
24 The Daily Nation, January 2009
the continent where Chinese investments are used to acquire the resources. Secondly, there is also the motive of seeking resources by the Chinese investments in the country. There is a Chinese company prospecting for oil in the country over the last five years but the failure to find deposits has not led to their abandonment of the prospecting activities. Thirdly, the infrastructural projects being undertaken by China for Kenya although are on one hand commercial ventures given that Kenya will eventually repay the concessional loans are on the other hand a pointer to the strategic objectives of China in the East African region. Good roads in Kenya, railway networks to South Sudan, Uganda and Ethiopia, a port in Lamu and a new oil pipeline to Uganda when completed, will give China unparalleled clout in the region. It will gain easier access to the markets in Kenya’s landlocked neighbours of whom Uganda and South Sudan have oil that will in the near future have to be exported via Kenyan railways, roads pipelines and ports. China is strategically positioning itself to benefit from the exports. Fourthly, the Government of China close association, support and monitoring of its investors in Kenya and probably in other countries points to China’s foreign policy orientation in which it is cultivating stronger political ties with developing countries under the South-South cooperation so as to support wider global political and economic objectives.

The findings of the study indicates that Chinese FDIs have generally been economically beneficial to Kenya as far capital injection particularly for infrastructural development, direct and indirect creation of employment, introduction into the market of a wide variety of cheap products the quality of some notwithstanding and the further opening up of the Chinese market for Kenyan exports. The hypothesis therefore hold because although there are limitations to Chinese investments that include limited technological transfers, weak backward linkages losses of jobs in Kenyan industries and businesses that fail to withstand competition, the losses are an
indication of weaknesses in the Kenyan economy and relevant government bodies to absorb FDIs, to direct FDIs to appropriate sectors and to monitor and even reject FDIs that are retrogressive to the country’s economic requirements. Chinese FDIs are therefore beneficial and should be encouraged but the government of Kenya should have better FDI monitoring and direction mechanisms.

The impacts of Chinese FDIs in Kenya are mixed with gains and losses to the economy. Therefore the hypothesis that warnings against Chinese FDIs should be ignored does not hold. Some of the sentiments including the possibility of market seeking Chinese FDIs flooding African markets with cheap Chinese products and destroying local industrial capacity is a real threat that Chinese FDIs pose for economies that lack mechanisms to monitor the activities and products of foreign investors. In Kenya the proliferation of Chinese products is already a threat to local industrialists. This is a warning that should be heeded and policy measures taken to ensure local industries and foreign investors complement each other and not one causing the demise of the other. The sentiment that China investments and economic cooperation will perpetuate poor governance, corruption and human rights abuses in Africa should be ignored. These problems stem from the internal structures of a country which can either perpetuate them or fight to eradicate them. There is no evidence that Chinese investments in Kenya have changed the political environment in the country. This sentiment suggests that African governments are generally corrupt, abusive and can easily be manipulated which is not true.

5.4 Recommendations

Based on the findings of this study, the impacts of Chinese FDIs in Kenya are mixed with gains and losses. The overall assessment of Chinese FDIs to Kenya is that they are good for the
development strategy of Kenya. Kenya can undoubtedly not afford to disregard China as a large scale financier of infrastructure especially in light of the current global economic climate where large values of capital from traditional investors has been reduced or withdrawn. It is apparent that China has a sound economic and political strategy in its engagement with Kenya and other African countries. Kenya should also have a sound strategy in its engagement with China. China’s claim that its policies are guided by principles of sincerity, equality and mutual benefit, South-South solidarity and common development should not be taken literally and China simply taken as a well meaning benefactor from the East. It is clear that China’s activities are mainly commercial and that China is here to make profits. China’s apparent readiness to fund development projects even if key to attaining the objectives of Kenya Vision 2030 should not be the key that opens up Kenya to all types of Chinese investors, traders and Chinese oil and mineral prospecting companies without proper negotiations that are in line with overall development strategy. This study recommends that firstly, Kenya should base all investments and all other economic cooperation spheres with China in trade and even development assistance on sound negotiation. Any deals and bilateral agreements signed with China should be well structured and drawn preferably by an international law firm with expertise in the relevant domain. This helps to build up safety nets for the future and allow the country to benefit more if the country discovers oil and mineral deposits for example. Kenya should as soonest as possible negotiate and sign a Bilateral Investment Treaty with China so as to remedy some of the disadvantages accruing to Kenya such as low technology transfers, poor backward linkages and the limited access to Chinese markets. China.

Secondly, this study recommends that the relevant government Ministries and Agencies such as the Kenya Investment Authority can be able to remedy the losses associated with Chinese
FDIs such as limited technological transfers, backward linkages with local producers, job creation, and unfair competition to local small and medium enterprises by improving their monitoring and management of all foreign investments. Chinese FDIs have been found to be almost fully owned and financed by the Chinese investors and therein lies the problem for Kenya. Joint ownership or ventures with local firms should be required so that they learn the Chinese methods of management and technology. In Agriculture for example, the Ministry of Agriculture should determine whether these investments are to supply China based manufacturers with agricultural raw materials. If this is so, Kenya will not benefit from value addition and the investors should be required not to ship out unprocessed agricultural products but to process them locally so that local nascent industries are developed. Investors that fail to do this should be rejected. The Government should also direct investments. The registration of many Wholesale and Retail and Import and Export Chinese investors in Kenya could result in the collapse of local production in the future. Whereas competition may be good for the development of these industries Kenya should be directing the investments to local manufacturing and more so in other towns and rural areas apart from Nairobi so as to develop backward linkages and directly create jobs. Instead of Kenya being the market for finished electronics products for example the Government should offer greater incentives than those currently offered to Chinese investors who set up local training and production plants. Kenya’s urban housing problems and the proliferation of slum dwellings should be a problem that the Government can also address using Chinese real estate investors. The Government’s inability to build adequate low cost housing for the urban poor stems from financial difficulties and the inefficiencies of the Ministry of Public Works. The answer is to outsource the development of
Chinese investments in Kenya have generally had positive impacts in Kenya’s economy. The Government must however direct and closely monitor these investments to address the losses associated with the investments and that the country benefits to the greatest extend. This study has identified the nature of Chinese FDIs in Kenya and has drawn conclusions as to their overall impact. Given the increasing numbers of Chinese FDIs in the country more research should be carried out as to the impact of each form of investment so as to make informed decisions as to which should be further encouraged for entry into Kenya and which should be discouraged.
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## Appendix I: China’s Foreign Direct investments in Kenya 2000-2010

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Activity</th>
<th>CAP CO STF US$ (000)</th>
<th>CAP CO STL US$ (000)</th>
<th>EMPF</th>
<th>EMPL</th>
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<td>Import &amp; Selling of milling machinery</td>
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<td>Value</td>
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<td>Flying Horse Ltd</td>
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<td>Focin Motorcycle Ltd</td>
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<td>Easy Flyaway Afric Tours and Travel Ltd</td>
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Key: CAP COSTF- Capital Cost Foreign
CAPCOSTL – Capital Cost Local
EMPF – Employment foreign
EMP L – Employment Local

Source: Kenya Investment Authority Data sets