

THE EFFECTS OF FOREIGN DIRECT
INVESTMENT (FDI) IN SUB-SAHARAN
AFRICA: A CASE STUDY OF CHINA'S
DIRECT INVESTMENT TO KENYA (2000-2006)

By

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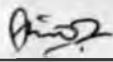
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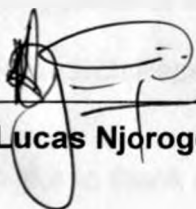
DECLARATION

I, Edwin Limo Kurui, hereby declare that this Research Paper is my original work and has not been presented for a degree in any other university.

Signed 

Date 12.11.08

This Research Paper has been submitted for examination with my approval as University Supervisor.

Signed 
Dr. Lucas Njoroge

Date 20/11/2008

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Finally, I am grateful to God for the sufficiency of his grace.

DEDICATION

This work is affectionately dedicated to:

My dear wife Nelly, my daughter

Janice and my son Jedidiah.

ABSTRACT

The purpose of this study is to investigate the effects of FDI from China on the Kenya economy. FDI, in recent years, has attracted a lot of attention as one of the economic growth drivers. Both developed and developing countries have as a central component the policy of attracting FDI. This form of investment is seen as essential for jump-starting economic growth through its bolstering of domestic capital, productivity, technological transfer and employment.

Well to do countries seek to invest in places where they are assured of maximum return. This phenomenon, which for a long time was a preserve of the developed countries, has now changed and even developing countries no longer remain at seeking to attract investment only, they are also venturing to invest abroad. Such developing countries that are known to want to invest elsewhere include China, India, Brazil among others.

Developing countries have come to the realisation that FDI, could after all, hold the key to fast-tracking their economic growth. The key to attracting foreign investment is the return that an investor stands to get. An investor will go any length if the returns are good. FDI in sub-Saharan Africa (SAA) yields relatively high returns. In 2002, the rate of return on FDI was highest in Sub-Saharan Africa, compared with other regions in the world, perhaps because, given perceived higher risks in the region, investors chose only high-return projects."¹

¹ www.worldbank.org

It is apparent that FDI plays an important role in the development efforts of the region. Although Africa faces challenges in politics and macroeconomic instability, weak infrastructure, poor governance, and inhospitable regulatory environments, still a lot of interests have been shown lately by Asian countries. China is one such country that has massively² invested in Africa.

This Research Paper seeks to investigate the effects of the Chinese investments in Kenya, the technology that has possibly been transferred and challenges that inhibits these efforts. The findings herein will hopefully open more interest for further research by scholars and students of international relations and economics. Such debate will shed more light on FDI and its effects.

² UNCTAD. *Prospects for foreign direct investment and the strategies of transnational corporations, 2004-2007*. (Geneva: United Nations Conference on Trade and Development, 2004)

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ABBREVIATIONS

AGOA	African Growth and Opportunity Act
BOT	Build Operate and Transfer
CBK	Central Bank of Kenya
CDMA	Code Division Multiple Access
CIDTPC	China Investment Development Trade Promotion Centre
CNOOC	China National Offshore Oil Corporation
CNPC	China National Petroleum Corporation
DC	Developed Countries
DCK	Dansk Chrysanthemum and Kultur
DFID	Department for International Development
EPZA	Export Promotion Zones Authority
FDI	Foreign Direct Investment
FIPA	Foreign Investment Protection Act
FOCAC	Forum on China-Africa Co-operation
GDP	Gross Domestic Product
GNP	Gross National Product
GOK	Government of Kenya
GSM	Global System for Mobile
IMF	International Monetary Fund
IPP	Independent Power Producer
KIA	Kenya Investment Authority
LDC	Least Developed Countries
MOFCOM	Ministry of Commerce (Chinese)
MOFTEC	Ministry of Foreign Trade and Cooperation
PPP	Public Private Partnership
SSA	Sub-Saharan Africa
UN	United Nations
WB	World Bank

CHAPTER ONE: FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH

1.0 INTRODUCTION

Foreign Direct Investment (FDI) ventures play an important role in global economy, linking rich and poor economies, and transmitting capital, knowledge, ideas and value systems across borders. It is a particularly appreciated source of capital because it has a more long-term character than portfolio investment, and direct investors make a stronger commitment to the host economy.

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FDI, apart from being a source of external finance, is also a means of integrating into the global marketplace. Africa has often been left out of FDI process because of small market size, poor infrastructure, weak regulatory framework, debt problems and, in some cases, political instability. Over the past decade, however, there has been considerable progress with reforms in several African economies.

FDI is a critical component to the growth of small, developing economies like Kenya's. Investing companies bring with them a number of invaluable benefits in addition to capital. These include established distribution networks, cutting-edge technology and top management skills. These benefits can lead to productivity gains throughout an economy, with spiralling effects being felt across the board.

Developing countries are always encouraged, by their developed counterparts and international organisations including the Bretton Woods institutions, to opt for FDI as a source of external finance and a means to faster development instead of relying only on local savings. The argument is, and has been, that FDI is superior to other types of

capital inflows in stimulating economic growth mainly because it is assumed to be less volatile, and offers not just capital but also access to modern technology and know-how.¹

FDI usually flows as a package; capital, production, technology, organisational and managerial skills, marketing know-how, and even market access through networks of enterprises involved in it. These resources tend to spill over to local enterprises and FDI ends up contributing to growth more in comparison with domestic investments from local savings.

The leading advantage of FDIs is that they raise world output by moving managerial skills and capital from regions where these factors are plenty, and thus attract low returns, to regions where they are scarce, and thus could earn high returns. Normally, direct investment benefits both the investing and hosting countries. For the host country, the immediate impact of direct investment is usually on improvement in performance in the balance of payments. FDI has the potential to generate employment, raise productivity, transfer skills and technology, enhance exports and contribute to the long-term economic development of developing countries in particular. More than ever, countries at all levels of development seek to leverage FDI for development.

Developing countries, especially in Africa, have recognised the need for foreign capital and the important role it plays in economic development. The United Nation's Millennium Declaration explicitly calls for greater FDI to Africa.²

¹ South Centre, Foreign Direct Investment, Development and the New Global Economic Order, Geneva: *A policy brief for the South*, 1997.

FDI takes numerous forms and enters into various sectors of an economy. Its effects can vary considerably ranging from positive to 'crowding out' of domestic investment and lowering of certain regulatory standards to attract it at the expense of enterprises. The effects of FDI can sometimes barely be perceived, while other times they can be absolutely transformative. While the impact and magnitude of FDI is dependent on many conditions, properly developed and implemented policies could help maximise the positive potential of FDI.

China has in the recent years enjoyed a booming economic growth.³ With this economic growth, China has steadily increased its influence and economic activity outside its borders and especially into Africa. Their effort has mainly been to access raw materials and markets for their products. Particular Chinese investments in Africa are in the energy and natural resources sectors. China has also invested in infrastructure development where Chinese firms' costs are said to be between a quarter and a half less than Western firms.

To succeed in FDI efforts and keep economic growth momentum, China has adopted several approaches. One has been investing in other countries especially fellow Third World. China has also forged closer diplomatic ties and gone full out to trade with other countries.

Their concentration has been the sub-Saharan Africa. Here they have dealt with countries like Kenya where they have exported machinery, textiles, agricultural tools and consumable goods and in turn imported fruits, scrap copper, cotton, hides and

² UNCTAD, *World Investment Report 1998: Trends and Determinants*, (Geneva: United Nations, 1998)

³ UNCTAD (2005) FDI prospects survey.

skins, coffee and tea. Kenya has been ranked third among the 24 southern and eastern African countries that trade with China.⁴

The Trade Law Centre for Southern Africa estimates trade volume between China and African countries in 2005 at over \$37 billion (U.S.), a record high and a sharp increase over the previous year's less than \$30 billion (U.S.). Much of this was due to increased exports to China from Africa.⁵

Table 1: China's Trade Volume to Africa in a Six Year Period

Year	Trade Volume in Billion US Dollars
2001	17
2002	19.4
2003	24
2004	29.8
2005	37
2006	48.9

Source: Trade Law Centre, 2006

The Centre adds that in the period, China imported more goods and services from African countries than it exported to them and notes that their investment in Africa is also expanding rapidly. Investments have been directed into numerous sectors that

⁴ <http://ke.china-embassy.org/eng/>

⁵ <http://www.tralac.org/>

include trade, resource development, transport, agriculture and processing of farm products.⁶

The rapid economic growth in Asia, China in particular, can be expected to lead to increased investments in Africa, in both natural resources and manufacturing. In particular, the rapid industrial upgrading taking place in China provides ample opportunities for Africa to attract efficiency-seeking and export-oriented FDI from Asian economies.

FDI is important to the development of third world countries, as it is a means of increasing the capital available for investment and the economic growth needed to reduce poverty and raise living standards. FDI is important in economic development as a means of increasing capital available for investment. It can also trigger growth that goes a long way in reducing poverty and raising the standards of living in a country. FDI has the potential to generate employment, raise productivity, transfer skills and technology, enhance exports and generally contribute to the long-term economic development. Countries at all levels of development seek to leverage FDI for their development.

The attractiveness of FDI is in the retaining of control over the invested capital by the investor. The transfer of capital across borders allows the receiving economy to increase investment beyond its own saving rate. Traditionally, development

⁶ Ibid

economics has focused on this addition to the capital stock as core contribution of foreign investment to economic development.⁷

Since FDI is the form that Chinese investment in Africa is taking, there is need to investigate its impact on the national economies. This becomes particularly important when seen in the light of the interests on raw material. Is the relationship mutually beneficial?

Like most governments in developing world, Kenya encourages foreign investors to establish themselves locally. Foreign investors seeking to establish a presence in Kenya take advantage of incentives like tax holidays. This is done to encourage investments that earn foreign exchange, provide employment, promote backward and forward linkages and transfer technology.

Policy investment laws in Kenya out-rightly promotes foreign investment. For example, Kenyan law prohibits nationalisation of private property without prompt and full compensation. The Foreign Investment Protection Act (FIPA) protects foreign investment against expropriation. Expropriation may only occur for either security reasons or public interest, where upon fair compensation is guaranteed.

Foreign investors look for foreign investments that might offer more attractive returns or lower risk than purely domestic investments.⁸ Kenya seems to fulfil this in its case with China. Traditionally, foreign investors have considered developed markets in their international diversification strategies. However, this is changing with investors now

⁷ S. Lall, and P. Streeten, *Foreign Investment, Transnationals, and Developing Countries*. (London: MacMillan, 1997)

⁸ J. L. Gitman and M. D. Joehnk, *Fundamentals of Investing (8th Ed)*, (New York: Addison Wesley, 2002)

turning to poor developing countries.⁹ The aggressiveness of China is a case in point. Developed countries have swarmed China and invested massively but the country too has reached out to invest in other countries.

Since the whole aspect of FDI is by all means too wide a field, this study zeros in on this type of investment coming to Kenya, a developing country in sub-Saharan Africa. To further help focus the study, we investigate the flow of this type of investment to Kenya with concentration being given to inflows from China.

1.1 STATEMENT OF THE RESEARCH PROBLEM

FDI is a significant source of external finance and a means of integrating into the global marketplace. Africa has often been left out as one of the FDI destinations mainly because of small market size, poor infrastructure, weak regulatory framework, debt problems and, in some cases, political instability.

In the past decade, however, there has been considerable progress with reforms in several African economies. These have been done at the prodding of the West and institutions such as International Monetary Fund and the World Bank. With the push and pull of economic reforms, Africa started looking for options towards accelerated economic development.

Africa's dealing with China has picked up tremendously since 2001. Apart from trade and aid, another focal point of interaction between Africa and China is in the area of FDI. Developing countries receive both official and private financial flows mainly

⁹ Solnik, B., *International Investments*, (4th Ed), (New York: Addison-Wesley, 2000) p299

because the level of domestic savings is generally low. At the same time the financial sectors of these countries are developing and most times remain repressed. This means the capacity to harness domestic financial resources for the development of key sectors of the economy is quite limited.

Although the level of FDI to Kenya can be said to be low, both in absolute and in relative terms, its impact on the economy cannot be underestimated. Foreign investors in Kenya have tended to make relatively small investments, but they are numerous and established across a wide variety of sectors. Foreign investors have also contributed significantly to some of the more dynamic sectors in the economy, including horticulture, and to export diversification. As mentioned elsewhere in this paper, there are significant weaknesses in data collection that has likely underestimated the actual flows of FDI.¹⁰

Arising from poor economic performance of the past decades, Kenya has taken its place as the regional business leader. It has retained regional advantages in FDI location, particularly as a result of the quality of its workforce and a central logistics position. Global shifts in manufacturing production, and to a lesser extent services, from the developed to the developing world have benefitted Kenya a great deal leading to attraction of new and dynamic FDI.

The importance of the above observations is that the relationship of the Chinese investments in Africa has certain results in the national economies of the states

¹⁰ World Bank. *Investment Climate Assessment: Kenya 2003. Initial Results and Comparisons*. (Washington, DC: World Bank, 2004)

recipient of Chinese FDI. The question that emerges in this investment relationship is what the outcome of the increased Chinese FDI in the national economy of Kenya is.

1.2 OBJECTIVES OF THE RESEARCH

The overall objective of this study is to make an attempt at tracking the FDI inflows from China to Kenya and the effects they are making locally. Specific objectives are:

- To evaluate how FDI flows from China to Kenya have impacted economic growth.
- To explore any new technologies introduced to Kenya by Chinese investors.
- To appraise the challenges that investors from China have encountered in establishing themselves in Kenya.

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1.3 JUSTIFICATION OF THE RESEARCH PROBLEM

For investors, a large part of the world's wealth lies outside their home country.¹¹ FDI in Kenya has been directed to a wide array of sub-sectors including, manufacturing, agriculture, tourism, financial and business services, telecommunications among many others. Whereas the impact of FDI in an economy is almost tangible, the sources targeted by various investors tend to differ from country to country.

In order to attract substantial FDI, any country needs to put in place sound policy reforms to attract substantially reasonable foreign investment. Any good policy is derived from well-researched information from whose basis decision is objectively

¹¹ Elton, Edwin, J. and Martin J. Gruber, *Modern Portfolio Theory and Investment Analysis* (5th Ed), (Toronto: John Wiley & Sons Inc., 1995)

made on way forward. A lapse in policy making can easily lead to obstacles being created instead of encouraging such noble idea of economic growth through FDI. In Kenya the passing of Investment Promotion Act (2004), introduced mandatory investment threshold and restrictive screening procedure for all foreign investments. These have become significant impediment to FDI inflows.¹² This paper will contribute not only as a tool of information but help in adding knowledge needed by policy makers to make sound decisions and hence sound policies.

This Research Paper seeks to unravel what the effects of FDI from China to Kenya's economic growth. The answers are important in understanding investment trends and add knowledge beneficial to both local, foreign investors, policy makers and the Government. Thus policy-makers will be able to come up with policies that will attract private capital and for investors; be able to make objective decisions and be able to direct investors on where to invest.

This Research Paper thus contributes to knowledge of FDI in as far as its flow to a poor country is concerned. The paper becomes important when the fact that the source, in this case China, is just but a developing country.

¹² UNCTAD, 'World Investment Report 2004,' *The Shift Towards Services*. (New York: 2004)

1.4 LITERATURE REVIEW

The world economy today is increasingly tapping into FDI for growth. Attracting FDI has become a key component of national development strategies for many countries. FDI is investment in businesses in another country which often takes the form of setting up of local production facilities or the purchase of existing businesses.¹³

Attracting FDI has become a central component in developed and developing countries across the world. A large volume of literature, identifying why firms engage in international investment, the determinants of investment location and the effects of FDI on economic development abound.

There is a body of literature¹⁴ that analyses the effect of FDI on economic growth and deals mostly with flows to various regions explaining how and why. Studies show the role that the flow of external financing could play in the development of recipient countries. The convergence of opinion seems to be that on the balance, there is a net positive relationship between external investment inflows and economic performance of countries, particularly if and when such inflows are received in a supportive legal framework.¹⁵

The disappointing economic performance of African countries beginning in the late 1970s up till the mid 1990s, coupled with the globalisation of activities in the world economy, has led to a regime shift in favour of outward-looking development

¹³ D. R. Rutherford, *Dictionary of Economics*, (London, 1995) pp178-179

¹⁴ Schoeman, N., Robinson, Z., & de-Wet, T. "Foreign direct investment flows and fiscal discipline in South Africa". *South African Journal of Economic and Management Sciences* 3, 2000, p235. Also Rogoff, K. & Reinhart, C., FDI to Africa: the role of price stability and currency instability, Washington: *IMF Working Paper 03/10*, 2003.

¹⁵ Burnside, C., and D. Dollar, Aid, Policies and Growth, *American Economic Review*, 90 (4), 2000, p847

strategies. Since the mid-1990s, there has been a relative improvement in economic performance in a number of African countries as a result of the change in policy framework.¹⁶

FDI is a low-cost source of know-how, especially for developing countries. The World Bank¹⁷ underscores this saying "FDI can be an extremely effective method of transferring operational know-how of new technologies, and can have numerous beneficial externalities." While FDI was four decades ago considered responsible for widening inequalities between industrialised and less developed countries, in recent years there has been more optimistic view on its role.¹⁸

Africa has not been a preferred destination for foreign investors and to address this challenge, efforts at the regional and international levels to improve the prospects for FDI flows have been mooted.¹⁹ Of great concern has been the macro-economic instability manifested through high incidence of currency crashes, double digit inflation, and excessive budget deficits. Indeed studies have shown that countries with high inflation tend to attract less FDI.²⁰ An economy that lacks investment will naturally drop in growth and all important sectors including capital markets are affected.

Until recently, FDI was not fully embraced by African leaders as an essential feature of economic development, reflecting largely fears that it could lead to the loss of political

¹⁶ Fischer, S., Hernandez-Cata, E. & Khan, M. S., "Africa: is this the turning point?" *International Monetary Fund Paper on Policy Analysis and Assessment*, PPPAA/98/6. , 1998.

¹⁷ United Nations Conference on Trade and Development, *World Investment Report*. (Geneva: UNCTAD, 1995)

¹⁸ Caves, R.E., *Multinational Enterprise and Economic Analysis*, (Cambridge: Cambridge University Press, 1996)

¹⁹ CCFA, "A ten-year strategy for increasing capital flows to Africa," *Report of US Commission on Capital Flows to Africa*, 2003.

²⁰ Onyeiwu, S. & Shrestha, H., "Determinants of foreign direct investment in Africa." *Journal of Developing Societies* 20, 2004, pp 89-106.

sovereignty, push domestic firms into bankruptcy due to increased competition and, if entry is predominantly in the natural resource sector, accelerate the pace of environmental degradation.

Moss, Ramachandran, and Shah²¹ argue that much of African scepticism toward foreign investment is rooted in history, ideology, and the politics of the post-independence period. They also argue that the prevailing attitudes and concerns in the region are due in part to the fact that policymakers in the region are not convinced that the potential benefits of FDI could be fully realised in the region. Clearly, the sector in which a country receives FDI affects the extent to which it could realise its potential benefits.

Studies on the effects of FDI in developing countries, list a range of benefits to recipient countries. At the macroeconomic level, FDI by definition brings new capital for investment, contributing to the balance of payments, adding to the country's capital stock, and potentially adding to future economic growth. FDI is also cited as a more stable type of capital flow, and thus is arguably more appropriate and development-friendly for low-income countries than portfolio flows.²²

The traditional view is that FDI improves economic growth by increasing the capital stock. Its diffusion tendency when it comes to passing knowledge has been noted.

²¹ Moss, T., Ramachandran, V., & Shah, M. "Is Africa's skepticism of foreign capital justified?" *Evidence from East African firm survey data*. Center for Global Development, Working Paper No 41. 2004

²² Blomström, M. and Kokko, A, "Multinational Corporations and Spillovers," *Journal of Economic Surveys*, 12; 1998 p247

This is because investors invest in research and development relative to sales and a large share of technical and professional workers.²³

Some restrictions limiting FDI is the foreign exchange liabilities of banks, financial transaction taxes, and bans on the sale of short-term securities to foreigners. The World Bank²⁴ notes that, capital controls do appear to be effective in reducing the magnitude and composition of investment, in the near-term.

One of the very important contributions of FDI to an economy is the ability of integration into the global economy. Openness to FDI enhances international trade thereby contributing to the integration of the host-country into the world economy.²⁵ It can also increase employment indirectly through increased linkages with domestic firms.

Opening up an economy to foreign firms increases the degree of competition in product markets thereby forcing domestic firms to allocate and use resources more efficiently.

1.5 THEORETICAL FRAMEWORK

This section seeks to set out the theoretical framework that informs the process of analysis undertaken in this paper. In particular, it introduces the main theory and subsequent approach that has been used as theoretical building block useful for investigating FDI and its effects on an economy.

²³ Markusen, J. R., "The Boundaries of Multinational Enterprises and the Theory of International Trade," *Journal of Economic Perspectives*, 9, 1995, pp169-189.

²⁴ United Nations Conference on Trade and Development. *World Investment Report*. (Geneva: UNCTAD, 1997).

²⁵ Morrisset, P. *Foreign direct investment to Africa: policies also matter. Transnational Corporation* 9, 107-25, 2000

The theoretical framework used in this paper to study the effects of FDI in sub-Saharan Africa is endogenous growth theory also called new growth theory. This theory argues that economic growth is generated from within a system as a direct result of internal processes. It also argues that the enhancement of a nation's human capital will lead to economic growth by means of the development of new forms of technology and efficient and effective means of production.

FDI to Africa accounts for over 60 per cent of private capital flows. While the flow of FDI is unmistakable, the growth effects remain unclear. The economic rationale for offering special incentives to attract FDI frequently derives from the belief that foreign investment produces externalities in the form of technology transfers and spill-over. Romer²⁶ for example, argues that important 'idea gaps' between rich and poor countries exists, hence can learn from each other. He says foreign investment can ease the transfer of technological and business know-how to poorer countries.

According to this view, FDI may boost the productivity of all firms, not just those receiving foreign capital. Thus, transfer of technology through FDI may bring substantial spill-over effects for the entire economy. On the other hand some writers predict that FDI in the presence of a pre-existing trade, price, financial, and other distortions will hurt resource allocation and slow growth.²⁷

Thus, prediction about the growth effects of FDI remains ambiguous. Some models suggest that FDI promotes growth only under certain conditions. Some sub-Saharan

²⁶ Romer, Paul, "Idea Gaps and Object Gaps in Economic Development." *Journal of Monetary Economics* 32, no. 3. December 1993: 543-73

²⁷ Boyd, John H., and Bruce, D. Smith. "Intermediation and the Equilibrium Allocation of Investment Capital: Implications for Economic Development." *Journal of Monetary Economics*. 30, 1992: 409-32

African countries have generated the interest of international investors by improving their business environment, suggesting that they can become competitive internationally and attract FDI on a sustainable basis. FDI is a globalisation phenomenon that has played a great deal in increasing competition between countries seeking to attract it.²⁸

Endogenous growth theory refers to economic growth within a system, usually a nation-state. The rise of endogenous growth model can be traced to economies and output of industrialised countries is now higher than in the past. Apart from technological advancement, there is also the growth in human capital.

The theory contrasts with neoclassical economics, which say technological progression and other external factors are the main sources of economic growth. Proponents of endogenous growth theory argue that the productivity and economies of today's developed world in comparison with same countries in pre-industrial eras clearly shows that growth was created and sustained from within the country and not through trade.²⁹

Endogenous growth theory addresses important questions on economic growth; why is the world measurably richer today than a century ago? Why have some nations grown more than others? The theory makes the point that knowledge drives growth. Since ideas can be infinitely shared and reused, they can be accumulated without limit. Increase in knowledge propels economic growth.

²⁸ Ibid

²⁹ Romer, Paul. "Endogenous Technological Change," *Journal of Political Economy*, Vol. 98, No. 5, "Part 2: The Problem of Development: A Conference on the Institute for the Study of Free Enterprise Systems." 1990, pp. S71-102.

The theory shows that economic growth does not arise just from increased labour and more capital, but from new and better ideas expressed as technological progress. This theory helps to make sense of shift from a resource-based economy to a knowledge-based economy. It underscores the point that the economic processes which create and diffuse new knowledge are critical to shaping the growth of nations, communities and individual firms.³⁰

Endogenous growth theory posits that FDI can improve both short-term and long-term rates of growth in the host economy through knowledge and technology spill-overs from research and development, and job training activities of investing companies.

The theory provides industrialising countries alternative ways to develop without becoming dependent on trade. Whereas traditional theories of growth focus on trade as the engine of growth; endogenous growth theory focuses on education, on-the-job-training and development of new technologies for the world market.³¹

1.6 HYPOTHESES

- The FDI inflows from China to Kenya have led to growth of local economy.
- Chinese investments in Kenya have led to introduction of new technologies.
- FDI inflows from China to Kenya are constrained by the political and social environments.

³⁰ Romer Paul. "The origins of endogenous growth." *Journal of Economic Perspectives*, 8(1), 1994. Winter: 3-22.

³¹ Romer, Paul. "Endogenous Technological Change." *Journal of Political Economy* Vol 98, No. 5, Oct. 1990. pp. S71-S102.

1.7 METHODOLOGY OF THE RESEARCH

The economic effects of FDI could prove difficult to measure accurately because they vary from time to time and from one host country to another and from one sector to another. The analysis of the effects of FDI in this study employs an empirical approach in aggregate and firm level analysis using official data-investment reports, survey and case studies of particular investments.

Primary data collection was done through self-administered interviews. Questionnaires were designed and circulated to selected firms were established in the period of study as having Chinese connection. The sampling process of selected firms was purposive and it sought to identify first the specific firms that had an attribution to China's FDI in Kenya. The sample was selected from list of investors provided by the Kenya Investment Authority (KIA). The list of investors was about 150 but not all these had starting operations in the country. It was established that about 80 investors were operating. Questionnaire was administered to all these and bearing in mind that there are other Chinese investors who are operating in the economy and might not have registered with KIA. The response from the investors was 47.5 per cent, having received 38 responses.

It is from these responses that tabulations were done by way of frequency tables, percentages, pie and bar charts. The Chinese companies have invested in, the amount invested, technology applied and number of locals employed in comparison with expatriates were some of the information sought. The aim of these was to gauge the effects of these investments by the Chinese.

Secondary data was collected from academic articles, grey material, media coverage and outputs from other applied research processes and government statistics. In analysing data, quantitative techniques such as graphs, tables and charts were employed. The data presented in this framework was qualitatively interpreted in conformity to the set objectives.

Some of the sources the data included the Central Bank of Kenya, Central Bureau of Statistics (Ministry of Planning and National Development); Directorate of Industries (Ministry of Trade and Industry), Kenya Investment Authority, the China Embassy in Kenya, International Monetary Fund (IMF) and the World Bank.

1.8 DEFINITION OF CONCEPTS

Foreign Direct Investments

FDI is an investment involving management control of a resident entity in one economy by an enterprise resident in another economy. It involves long-term relationship reflecting an investor's lasting interest in a foreign entity.³² FDI has also been said to be an investment in foreign assets, such as foreign currency, credits, rights, benefits or property, undertaken by a foreign national for the purpose of production of goods and services, which are to be sold either in the domestic market or exported overseas.³³ Simply put; any flow of capital from a foreign country to purchase ownership in real investment such as factories, capital goods, land investment, mining, financial market etcetera is FDI.

³² www.unctad.org

³³ Investment Promotion Center Act, Chapter 518, www.investmentkenya.com

FDI is seen as an essential component for jump-starting economic growth through its bolstering of domestic capital, productivity and employment. FDI allows for transfer of capital across borders, making the receiving economy to increase investment beyond its savings rate.

The movement of productive resources across borders to countries experiencing scarcity is believed to have the tendency to equalise factor returns internationally and generally trigger economic growth. This could explain the perception that FDI is an important component to growing economies of less developed countries.³⁴

1.9 SCOPE AND LIMITATION OF THE RESEARCH

The Research Paper covers the FDI from China to Kenya in the period 2002-2006. The time frame that has been set is ideal for the study for three reasons. First, it covers a time period in Kenya when there was a change in political leadership, and the country was looking out for development partners from across the board. One area Kenya considered in looking for new partners was Asia and in particular China. Secondly, it is a time when the Kenyan economy registered an upward trend in growth after many years of economic regression. Thirdly, Chinese economy has grown exponentially in the last decade. With a huge population, China started looking out for raw material and new fronts for business. This was more attested during the period in question since it is the time they made their pronounced entry to Kenya. The information gathered was sufficient to make observations on the impact of FDI from China on Kenya's economy.

³⁴ B. Solnik, *International Investments*, (4th ed), New York: Addison-Wesley, 2000) p303

A major limitation during the study was access to vital statistics from the concerned parties. Most Chinese firms were unwilling or feigned failure to understand English. It was from those identified that a study sample was taken. The Kenya Investment Authority was relied upon to provide a list of the investors (Refer to list attached in the Annex I). They, however, made it clear that their list was only those that registered with them and reckoned there were many others that might not have gone through them. Many other Chinese firms have entered directly into the Kenyan economy without necessarily going through the Authority. The study therefore approached all those provided in the list of 80 investors and got a response from 38 of them.

1.10 ORGANISATION OF THE REST OF THE RESEARCH PAPER

Chapter TWO is composed of a historical perspective of China's FDI to Kenya. The chapter outlines the investment relationship China has had with Africa and specifically Kenya. It traces the various approaches that China has used to make entries into the continent including development aid, trade and investment. The chapter further enumerates China's investments in the region and why the interest and specific dealings with Kenya.

Chapter THREE looks into the contribution of China FDI to Kenya's economic growth. Here the research investigates the potential impacts of FDI to Kenya's economic development. Various contributions of the same include capital, employment, international trade, technology transfer, and government revenue are discussed.

Chapter FOUR deals with data analysis and presentation. It goes deeper than chapter three and makes the actual analysis. Data from questionnaire analysis are presented here and conclusion made on the effects of the FDI from China on Kenya's economy.

Chapter FIVE makes conclusions and recommendations. Based on the findings of the research, conclusion of the study are made here. Recommendations as to the way forward are also made proposing further need for study and investigation of the subject matter.

CHAPTER TWO: HISTORICAL PERSPECTIVES OF CHINA FDI TO AFRICA

2.0 Introduction

Although China is itself a developing country, it has become a major player in the development of sub-Saharan Africa. Its brisk growth has led to insatiable hunger for oil and other raw materials. It is not surprising therefore, that China today is dealing with resource-rich Africa in unprecedented relationship. Chinese companies are investing across the continent.

The story of China-Africa relationship dates many years back. With an ever growing population, China has had to strategically work at having its population develop economically. China-Africa relationship has been a case of 'courtship' with the former doing the wooing of the later. The entry points have been trade, aid, education, investments among others.

Economic relationship between China and Africa has expanded enormously in recent years. In the past 15 years for example, China has emerged as an important destination for Africa exports. In 2005, SSA exports to China amounted to US\$ 19 billion, compared with negligible levels in 1990 and about US\$ 5 billion in 2000. Growing by 30 per cent annually since 2000, they account for about 20 per cent of Africa's total export growth since then. Africa, and in particular SSA, imports from China have also surged, from US\$ 3.5 billion in 2000 to over US\$ 13 billion in 2005.

Nearly all these imports are manufactured products, reflecting China's emergence as a major exporter of manufactures in recent years.³⁵

Over the past 25 years, FDI from China to Africa has increased substantially, from US\$ 11.8 billion in 1980 to US\$ 25.6 billion in 1990 and to more than US\$ 101 billion in 2004. Moreover, as a per cent of GDP, the stock of FDI in Africa increased from 10.2 per cent in 1980 to 29.4 per cent in 2004. A new source of funding has emerged from a small number of investors who are interested in adding to their portfolios debt securities issued by governments in the region.

2.1 China's Entry into Africa

The interest of China in Africa and specifically sub-Saharan Africa (SSA) is both historical and strategic. This dates back to pre-independence period when China identified with countries fighting imperialism. Indeed the ties go back to the 1950s when Beijing got behind various independence movements as a means of countering United States of America and Soviet influence in the region. This was to continue later during the cold war period.

In playing out this role as an anti-imperialist counterweight to the West, China infiltrated parts of the world overlooked by the United States and the Soviet Union. China used a three-pronged approach in doing this namely; development aid, trade and investment. It is under their development aid approach, for example, that China funded the construction of Tanzam railway line running between Tanzanian and Zambian capital cities.

³⁵ www.imf.org: *Direction of Trade Statistics*.

China's financial assistance to SSA region in development aid is substantial. In October 2006 at the Beijing Summit, China announced assistance of about US\$ 5 billion. The beneficiaries of the largest flows are largely SSA countries including Kenya.³⁶

Further, most loans from China to SSA countries are on concessional basis although this varies widely. Some large loans and credit lines have not been fully concessionalised, although they are on more favourable terms than the market.

On trade, China sought to establish relationships with countries in Africa through signing of pacts including military cooperation. This ensured an outlet for their arms and more so technological innovations. To this end, China's entry point became that of its ideological friends like Ethiopia, Uganda, Tanzania, Zambia and major non-aligned countries such as Egypt.

Between 1955 and 1977, China sold US\$ 142 million of military equipment to Africa. It also opened doors of its universities where 15,000 African students have studied in China since the 1950s.³⁷ The number of students receiving scholarships to study in China has recently risen not to mention the training institutions started in the continent teaching among others Chinese languages. The Confucius Institute in the University of Nairobi is one such case.

The Chinese presence in Africa has been typified by technicians and experts sent to boost nations post cold war status and nurse injuries caused in the four-decade war.

³⁶ www.gov.cn, China's African Policy, 2006

³⁷ Jean-Christophe Servant, *Le Monte Diplomatic*, English Edition, 2005; <http://mondediplo.com/2005/05/11chinafrica>

The presence has seen some 15,000 doctors and more than 10,000 agricultural engineers sent to mostly SSA countries and previously cold war arenas.³⁸

Until the mid-1970s, co-operation meant building solidarity between two continents that belonged to the same under-developed world. With their heightened economic development however, China has attained new status bordering the brink of newly industrialised nation. China now approaches Africa as a development partner and not as a country on the same footing.

By 1977 trade between China and Africa had recorded a whopping US\$ 817 million. Even in the 1980s when cold war powers pulled apart and halved aid to SSA, China remained a friend to the region. At around this time also, China had packed away from its revolutionary approach to world politics and concentrated more on fostering external trade and foreign investment. By the time that post-cold war geopolitics and developments in the Middle East was drawing traditional players back into Africa, China had turned itself into the workshop of the world and had its eye on Africa's raw materials.³⁹

At the close of cold war, China was set to make a move and just waited to be triggered. This came soon thereafter where scholars observe that China started pursuing a more active foreign policy extending beyond its Asian neighbourhood since the early 1990s. The Tiananmen Square massacre seems to have induced China to seek closer ties with non-Western countries to shield itself from Western criticisms.

³⁸ Ibid

³⁹ Ibid

Given their numerical strength, African states played an important role in this stratagem.⁴⁰

2.2 Foreign Direct Investments in sub-Saharan Africa

The third and the most important of the three-pronged China's approach to SSA is that of investment which is deeply spiced with aid. Chinese firms focus on specific sectors. The country 'vigorously encourages its enterprises to participate in the building of infrastructure in African countries, scale up their contracts and gradually establish multilateral and bilateral mechanisms on contractual projects'.⁴¹

China has, therefore, become a major player in the field of infrastructure activities; transportation, telecommunications, water conservancy and electricity. Many of the projects are not commercial and are financed by 'tied aid'. Others are not profitable because the Chinese tend to set costs at below market rates, although the projects may be profitable in the long run.

China is pushing different countries targeting different but specific sectors. In more than a dozen countries, Chinese firms are searching for oil and gas while rebuilding electrical grids and telecommunications networks.

China has spent billions of dollars securing drilling rights in Nigeria, Sudan and Angola, and has exploration or extraction deals with Chad, Gabon, Mauritania, Kenya, the Republic of Congo, Equatorial Guinea and Ethiopia.

⁴⁰ Tull, Denis M., "China's Engagement in Africa: Scope, Significance and Consequences." *Journal of Modern African Affairs*, Vol. 44, No. 3., 2006

⁴¹ www.gov.cn. China's African Policy, 2006

In Nigeria, where oil is abundant, China is rebuilding the railways. In Rwanda, Chinese companies have paved more than 80 per cent of the main roads, and in Zambia, Chinese companies own one of the country's largest copper mines. They have become investors in the booming copper industry here and in Congo. They have been major buyers of timber in Gabon, Cameroon, Mozambique, Equatorial Guinea and Liberia.

FDI from China to Africa has substantially increased in the last decade with Chinese enterprises investing about US\$ 1 billion a year. Much of FDI from the country has gone to the extraction industries, and is mainly extended to fragile states such as Sudan, DR Congo and Angola. Sudan and Nigeria, for example, have so far attracted nearly US\$ 200 million in Chinese FDI. While globally small, China's FDI in Africa represented US\$ 900 million of the continents US\$ 15 billion in 2004.⁴²

The impact of China in SSA is aptly captured by the statement that it is doing more than the G8 to make poverty history '...if a G8 country had wanted to rebuild the stadium, we would still be holding meetings! The Chinese just come and do it. They don't hold meetings about environmental impact assessment, human rights, bad governance and good governance. I'm not saying it is right, just that Chinese investment is succeeding because they don't set high benchmarks.'⁴³

The 674 Chinese state companies⁴⁴ involved in Africa have invested not only in booming sectors such as mines, fishing, precious woods and telecommunications, but

⁴² Ibid

⁴³ Hilsun, L., *We Love China*, (London: Granta Publications, 2005), <http://www.granta.com/extracts/2616>

⁴⁴ Ibid

also in others that the West has neglected, even abandoned, as less profitable. As a result, Zambia's Chambezi copper mines are being worked again and supposedly exhausted oil reserves in Gabon are being explored.

There has been marked increase in China FDI flows to Africa coming with a new aid-investment nexus between Asian countries and their African partners. China, for instance, plans to increase contributions to its African human resources development fund by 33 per cent and to provide training to 10,000 African personnel by 2008.⁴⁵

Outward FDI from developing Chinese economy has grown significantly since the early 1990s. Outflows from the region have reached a new high of an estimated US\$ 90 billion in 2006. Only a small percentage of Asian FDI is currently targeted at SSA. But this is changing with more players mainly China taking keen interest in the region because of the mutual interests they represent. The Chinese presence in Africa and Kenya appears to be driven primarily by the strategic search for raw materials rather than for final markets or for low-cost production platforms.

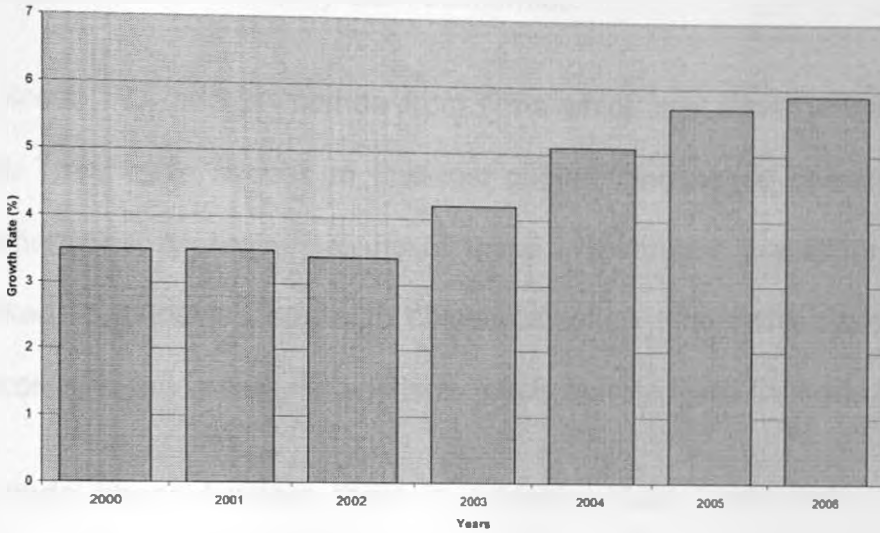
After many years of economic stagnation, and at times even decline, SSA is experiencing an economic resurgence. Between 2001 and 2006, growth in gross domestic product (GDP) in the region averaged 4.9 per cent annually, according to the IMF.

China's increasing volume of FDI is helping to diversify Africa's options, and to the extent that investment and the associated aid help to create stronger domestic

⁴⁵ *Jeune Afrique*. "The African report: an insight into Africa, an outlook on the world", Number 2, March 2006

production capacity. It may influence Africa's economic relations with the world generally, particularly in trade.

Table 2: Growth in GDP in sub-Saharan Africa



Source: *World Development Indicators 2007*

In 2006, Africa as a whole grew by an impressive 5.5 per cent and sub-Saharan Africa in particular by 5.7 per cent. In 2007 these rates are expected to increase even further—to 6.2 and 6.8 per cent, respectively - the highest growth registered for decades. In parallel, FDI has been picking up, with increasing activity by booming emerging markets, drawn by the continent's rich natural resources.

Other realms of activity are in infrastructure development (Chinese firms appear to have costs which are one-quarter to one-half less than Western and South African firms), in small enterprises in some countries (for example Sierra Leone), in trading (for example, Namibia), and in farming (for example, as is emerging in Mozambique).

In a study conducted for DFID, Kaplinsky and Morris, domestically produced clothing and furniture manufactures in both Ghana and South Africa are being displaced by imports from China.⁴⁶ Similar anecdotal evidence can be found with regard to clothing and footwear manufacture in many SSA economies.

Much of Chinese FDI in SSA comes from firms which are either wholly or partially state-owned. They have access to low-cost capital, and hence operate with much longer time-horizons. Moreover, many of these investments are either explicitly or implicitly linked to achieving strategic objectives, often those which are focused on long-term access to raw materials, and are closely bundled with Chinese aid.

Unlike the trade channel where there is extensive data (particularly in relation to aggregate flows, and flows over time); data on FDI flows is limited. In part this is because FDI is inherently difficult to measure. It is also not clear how much of Chinese economic activity in SSA comprises FDI, how much is a result of winning commercial tenders, how much is linked to Chinese aid and how much is part of integrated production networks between Chinese and local firms.

The anecdotal evidence emerging from SSA is that in many countries, there is a rapidly growth evidence of Chinese entrepreneurship, sometimes through large firms (such as in infrastructure projects), and in other cases through smaller scale initiatives (such as in Kenya, Sierra Leone and Namibia).

⁴⁶ Kaplinsky, R. and M. Morris, *Dangling by a thread: How sharp are the Chinese scissors?*, (Brighton: Institute of Development Studies, 2006)

FDI is a significant source of external finance and a means of integrating into the global marketplace. So far, Africa has been left out of this process. This may be attributed to small market size, poor infrastructure, weak regulatory framework, debt problems and, in some cases, political instability. Over the past decade, however, there has been considerable progress with reforms in several African economies.⁴⁷

In September 1997, upon the approval of MOFTEC, Sichuan Provincial Imports Development Corporation started undertaking in Kenya 'China Investment Development Trade Promotion Centre.' Central Fund for Foreign Trade was identified to fund the Centre to the tune of US\$ 2 million. The State Council later in October 1998 ratified the usage of the said amount from the Central Fund.⁴⁸

In 2000, the Chinese Government established with African countries (including 25 LDCs) a Sino-Africa economic and social cooperation mechanism under the Forum on China-Africa Cooperation (FOCAC). This mechanism encourages and supports China's outward investment and business in Africa and provides preferential loans and buyer credits to build up Africa's infrastructure.

The FDI is mainly from parastatals that have access to low-cost capital, so that the Chinese investors have long planning horizons. These firms view the challenging political and economic environment in many African countries as an economic

⁴⁷ UNCTAD/UNDP publication, *Asian investment in Africa: a new era of cooperation*, 2007, <http://www.unctad.org/TEMPLATES/Page.asp?intItemID=4179&lang=1>

⁴⁸ www.gov.cn, China's African Policy, 2006

opportunity. They derive huge profits from rates of return to FDI that are said to be much higher in politically volatile African countries than elsewhere.⁴⁹

Chinese government has also been known to target 'easy prey' countries suffering from Western-imposed sanctions. These sanctions tend to turn those countries into niche markets, making China an alternative partner of 'pariah states' for example as in the cases of Sudan and Zimbabwe.

In Sudan for example, China first established a presence in the unexploited Muglad oilfields of southern Sudan 10 years ago. Now it imports 50 per cent of the region's crude oil, and 13 of the 15 most important foreign companies operating in Sudan are Chinese; China National Petroleum Corporation and Zhongyuan Petroleum Corporation.

In 2004 Chinese investments represented more than US\$ 900 million of the US\$ 15 billion of FDI in Africa. Of the thousands of projects under way, 500 are being exclusively directed by the China Road and Bridge Corporation, a state enterprise, helping to place 43 Chinese companies among the 225 global leaders in the area.

Thus China has seized every opportunity to make its presence felt in Africa. To a large extent this no mean feat has been realised. In Ethiopia China is involved in telecommunications; in the Democratic Republic of Congo it has done work for Gecamine, the state-owned mining company; in Kenya it has repaired the road linking Mombasa and Nairobi; and it has launched Nigeria's first space satellite. As an incentive to Chinese nationals, eight African countries have been officially designated

⁴⁹ Ibid

tourist destinations. All these are deliberate moves to make presence felt in SSA. China has indeed been felt here and FDI is one of the vehicles.

Growth rates in SSA have been rising in recent years as greater macroeconomic stability has been achieved in more countries and additional reforms have been undertaken. But the key to maintaining growth is not simply mobilising more capital or labour. What is needed is greater productivity—being able to produce more with the same inputs. Productivity growth in Africa has been lower than in other regions. The average productivity growth from 1970 to 2000 was stagnant or even mildly negative.⁵⁰ This rosy picture when juxtaposed with the happenings in SSA which have failed in achieving economic growth shows the gap in key sectors for foreign direct investments. It is instructive to note that six of the 10 worst performing economies in the world are located in SSA. The nearly 750 million people who live in SSA are among the world's poorest.

There has also been a relatively large migration of the Chinese peoples to SSA in the recent past that have set up trade enterprises including small outfits such as food joints. Although the migration of people of Chinese and Indian origins began thousands of years ago, with for example Kenyan Asians from India in past migrations owning 75 per cent of the large manufacturing firms in the country.⁵¹ According to

⁵⁰ Bosworth, B. and S. Collins. "The Empirics of Growth: An Update." *Brookings Papers on Economic Activity Issue 2*: 113–206. 2003, p102

⁵¹ McCormick, Dorothy, "China, India and African Manufacturing: Framework for Understanding the Impact of Aid and Migration." *Paper prepared for African Economic Research Consortium*. 2006.

some estimates,⁵² some 80,000 migrant workers from China have recently moved to Africa, creating a new Chinese Diaspora.

This movement of personnel to SSA is attributed to growth experienced by the East Asian economies in the last two decades. Among the 10 fastest growing economies, five are located in East Asia. China is the star performer, having achieved an average growth rate in the region of 10 per cent during the period.

The basis for China's rising trade links with SSA has been its extraordinarily rapid growth that has remained high since 1979. One of the main features of this growth has been its deepening trade orientation, with the trade-GDP ratio in excess of 70 per cent, well above the 'norm' for large countries. Within this, China has become a major exporter of manufactures and a significant importer of commodities.

This scenario has given China more investment opportunities in the national economies than it anticipated for in laying foothold in the region. To foster the economic growth required to create jobs, raise living standards, and hasten development, SSA nations are doing all that is possible to attract foreign capital.⁵³ This has proved instrumental in raising productivity in many countries by enhancing imported technology and the transfer of know-how.

Most of SSA nations have deliberately taken steps to lure investors. They have changed fiscal and monetary policies to create a more stable economic climate. They

⁵² Obwona, Marios and Ephraim Chirwa, "Impact of China and India on SSA Agriculture: Issues and Challenges." *Paper Prepared for African Economic Research Consortium, 2006*

⁵³ www.worldbank.org

have reformed markets and increased legal protections for investors.⁵⁴ For China, however, all these are but details; they will still come anyway for their concern is what they seek, not the conditions for where they seek it.

With the knowledge of what they seek, China has increased their financial assistance to SSA. This has been in the form of loans, grants, debt relief, or direct investment.⁵⁵

The share of SSA's exports to developing countries has more than doubled since 1990. As Asia industrialises, its demand for natural resources increases and SSA has responded to the export opportunity. Asia now receives about 25 per cent of SSA's exports. China and India together account for about 10 per cent of both SSA exports and imports—25 per cent more than the share of these two countries in world trade.⁵⁶

That China's importance in SSA is growing is in no doubt. Only this year (2007) the African Development Bank (AfDB) for the first time in its 43-year history, held its annual meetings in Shanghai, with the banner theme: 'Africa and Asia: partners in development.' It is instructive that China's share of SSA's total exports rose to 10.8 per cent in 2006 from 4.2 per cent in 2000.

2.3 Investment in the Energy Sector

The emergence of China as an important trade partner and investor in SSA is most pronounced in fuel and raw materials search. From small amounts in 1990 China's share increased to one-fourth of raw materials and one-sixth of fuels in 2005.

⁵⁴ Ibid

⁵⁵ World economic and financial surveys, *Regional economic outlook: Sub-Saharan Africa*, (Washington, D.C.: International Monetary Fund, 2007).

⁵⁶ Broadman, Harry G., 2006, *Africa's Silk Road: China and India's New Economic Frontier* (Washington: World Bank).

China's fast-rising involvement with Africa grows out of its immense and growing need for natural resources, in particular for imported oil, of which 25 per cent now comes from SSA. China has made these strides in spite of lacking the economic and political ties that Western Europe has with Africa as a legacy of colonialism, and the economic power that the United States wields because of its wealth and influence in international financial institutions.⁵⁷

China has mainly used its state-owned companies in making investments in SSA. These have often entered into joint ventures with equally SSA state-owned companies for resource-based projects. The Chinese company Sinopec, for example, has invested US\$ 3.5 billion in a partnership with Angolan Sonangol to pump oil from offshore blocks.⁵⁸

Elsewhere in Gabon, another company CMEC/Sinosteel consortium is reported to be investing about US\$ 3 billion in exploiting iron ore deposits. It is also constructing a railway, a port, and a hydroelectric power station in return for exclusive rights to develop the mine. And a subsidiary of the China National Offshore Oil Corporation (CNOOC) recently signed a production-sharing contract with the National Oil Company of Equatorial Guinea (GEPetrol).⁵⁹

These indulgences of China with SSA are further underscored by their strategic aid to the region and to the sectors of interest. China's aid to SSA is largely aimed at financing projects in energy, telecommunications, and transportation. These are

⁵⁷ Allen, Franklin, Jun Qian and Meijun Qian (2005) "Law, Finance, and Economic Growth in China," *Journal of Financial Economics*, 77: 57-116.

⁵⁸ <http://www.nytimes.com>

⁵⁹ Rugman, Alan M. *The Theory of Multinational Enterprises*. (Cheltenham: Elgar, 1996).

extended with soon to follow deals to develop mining and energy resources. For example, in return for the right to explore and exploit natural resources in the Republic of Congo, China is helping to build transportation, energy, telecommunications, and water facilities and is providing support for social sectors.

China's activities in construction and infrastructure predate its interest in resource-linked investments; construction companies were the first Chinese companies to enter Africa. For example, China was involved with the Tanzania-Zambia railway construction in 1970s.⁶⁰

Since most infrastructure projects are public-sector works, China considers its investment as goodwill projects to woo the sympathies of African leaders. This enables it to gain political influence, which often opens the doors to commercially or strategically more attractive business in other sectors such as tenders for oil or mining concessions.

2.4 China-Kenya Bilateral Investment Arrangements

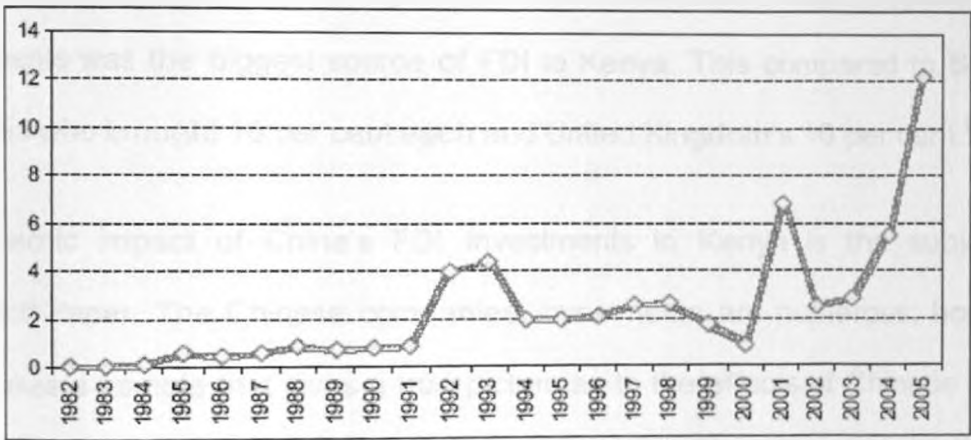
Kenya established diplomatic relations with China in December 1963 when Kenya attained its independence. On May 23, 1978, the two governments signed an agreement stipulating that bilateral trade between the two states would be settled onwards by cash. From that time bilateral trade has grown steadily reaching US\$ 100 million in 1995. The trade volume hit US\$ 133.35 million in 1997. In 1999, the total

⁶⁰ Akinlo, A. E. "Foreign direct investment and economic growth in Sub-Saharan Africa." *International Review of Economics and Business*, 2003 p569.

bilateral trade was worth US\$ 105.53 million, among which China exported US\$ 100.61 million and imported US\$ 4.92 million.⁶¹

An important, and almost certainly significant (albeit poorly documented) channel of Chinese presence in Kenya is the growing number of Chinese traders to be found locally. However trends indicate that trade volume between the region and China is on an upward trend in the past 15 years as demonstrated in the table below:

Table 3: Outward FDI flows to African countries from China, 1982-2003 (in Million Dollars)



Source: UNCTAD, based MOFCOM

According to the statistics from the Chinese Department of Development of the Ministry, a total of 18 projects (filed and approved by the Ministry) had been implemented in Kenya by the end of June, 1999 with the overall investment reaching 12.524 million dollars and 9.09 million dollars.

⁶¹ <http://www.state.gov/e/eeb/ifd/2006/62005.htm>

Foreign investors from China have tended to make relatively small investments, but they are numerous and established across a wide variety of sectors. They have contributed significantly to some of the more dynamic sectors in the economy, including horticulture, construction, tourism, and manufacturing assembly

The FDI realised has increased capital inflow, with new employment opportunities bringing additional income and spending power for host country and its people while improving competitiveness of local firms in the global arena.⁶²

The Kenya Investment Authority figures for 2002 show that China's 20 per cent of total investments was the biggest source of FDI to Kenya. This compared to South Africa and India who brought 16 per cent each and United Kingdom's 10 per cent.⁶³

The specific impact of China's FDI investments in Kenya is the subject of this Research Paper. The Chinese companies' investments are numerous; however, this study takes a sample that gives a true picture as to the effects of Chinese investment in Kenya and indeed the larger region of SSA.

⁶² www.kipora.org

⁶³ <http://www.investmentkenya.com>

CHAPTER THREE: CHINA'S FDI PLACE IN KENYA'S ECONOMIC GROWTH

3.0 Introduction

Although the level of FDI in Kenya has generally been low, its impact on the economy cannot be underestimated. FDI has tended to be in small quantities, but are numerous and established across a wide variety of sectors. This is attested by the research done on Chinese investments in Kenya which is the subject of this paper. Foreign investors have thus contributed significantly to some of the more dynamic sectors in the economy, including horticulture, communication, manufacturing, export diversification among others.

This chapter seeks to specifically highlight the possible contribution that Chinese investments in Kenya has had. Of special interest are the effects of these investments in the economy and the technologies brought in. The chapter also looks at the import market opportunities that have resulted because of Chinese investment in Kenya. The link to globalisation, revenue generation and employment creation are also considered. In concluding the chapter, possible negative effects of FDI including 'crowding out' are looked at.

FDI has been described as the engine of growth in an economy, not least of all a developing one. This is because of its role of availing needed capital for investment, increasing competition in host country, for example in local manufacturing and export. Another important role is the aiding local firms to become more productive through adoption of more efficient technology. In addition to the above roles, FDI also leads to

investment of the human resource through training and exposure to new ways of doing things.

3.1 Opening Market Opportunities

FDI contributes to growth in a substantial manner because it is more stable than other forms of capital flows. The benefits of FDI include serving as a source of capital, employment generation, facilitating access to foreign markets, and generating both technological and efficiency spill-over to local firms.

It is expected that by providing access to foreign markets, transferring technology and generally building capacity in the host country firms, FDI will inevitably improve the integration of the host country into the global economy and promote growth. FDI is seen as "a key driver of economic growth and development. FDI not only boosts capital formation but also enhances the quality of capital stock".⁶⁴

China has over time emerged as a major power within the global economy. This status derives primarily from its phenomenal economic growth in the past 20 years. During this period, China's economic growth has been doing an average of 10 per cent per annum.⁶⁵

With this kind of growth, China has been forced to find new sources of both raw material and market for inputs for its industries and market for products respectively.

As an integral part of this, exports from sub-Saharan Africa to China have grown

⁶⁴ Holger Gorge and David Greenaway, "On Whether Domestic Firms benefit from Foreign Direct Investment," (*The World Bank Research Observer* Vol. 19 Number 2 pp.171-197). 2004

⁶⁵ China's African Policy, 2006, www.qov.cn

steadily during the last decade and, as a result, Africa's trade dependence has been switching gradually from the West to the East. This has also been facilitated by China's determined efforts since the late 1990s to strengthen its economic and trade links with many African countries.

In Kenya, the country has put in place measures to attract FDI. Kenya has five export processing zones. The zones offer considerable advantages such as a 10-year tax holiday, a 25 per cent tax rate for another 10 years, exemption from import duties, exemption on value added and sales taxes and no restriction on management or technical agreement. Special incentives are given to transnational corporations (TNCs) that invest in lesser developed areas.⁶⁶

There are no restrictions on foreign investment, or on foreign ownership in Kenya. Repatriation of profits is unrestricted. The legal framework for FDI in Kenya is provided by the Companies Ordinance (Chapter 486), the Partnership Act (Chapters 20 and 30) and the Foreign Investment Protection Act. The economic liberalisation programme covers manufacturing and agriculture sectors.⁶⁷

FDI to Kenya has in the past suffered from a combination of poor investment climate, high external indebtedness, low domestic saving and the need for fiscal consolidation thus reducing the much needed capital.⁶⁸ This has, however, changed in the recent past as shown by interests by firms from across the world and especially from Asia and China in particular.

⁶⁶ www.centralbank.org

⁶⁷ www.investmentkenya.com

⁶⁸ IMF. Regional Economic Outlook: Sub-Saharan Africa, (Washington DC,; IMF, 2007), pp 53-54

3.1 Global Competition

The world has become a global village in matters of trading with each other. One high point of FDI is market access. Foreign companies provide access to export markets, especially for the products they produce. In the same breath the local products that had earlier not managed to access the international market stand to benefit.

FDI holds the top position as one of the easy way out of entering the international production systems that increasingly dominate trade in sophisticated and high-tech products. The resultant foray in the international market comes with numerous benefits including technical information, realisation of scale economies, competitive stimulus and market intelligence.

Competition at global level would under normal circumstances be vicious, locking out many products from many developing countries. FDI improves competition. The confidence of consumers is won over through improved product quality, the availability of additional products in the market, the expansion of the product market and competitive prices. But speaking of competition, entry of foreign companies often may lead to straining of small local producers in the host country. These companies if they fail to cope with the competitive prices end up being crowded out.

3.2 Employment Generation

FDI can become an important source of employment generation. With the establishment of new ventures in the host country, new jobs are generated. The employment creation of FDI should, however, be looked at as a whole because at

times there is loss of employment where FDI leads to privatisation and subsequent leaner workforce established for profitability.

Generally however, there is economic growth whether jobs are created or lost for efficient productivity. Kenya's manufacturing FDI has concentrated on consumer goods sectors including food and beverage industry. This has lately been overtaken by the growth of the garments sector because of the readily available American market under AGOA. Of 34 companies producing garments under AGOA arrangement 28 are fully foreign-owned.⁶⁹ AGOA-related investments in the recent past have represented around 80 per cent of FDI. These investments no doubt increased employment and exports hence making an impact on the Kenyan economy. It is instructive to note that these foreign apparel firms are labour-intensive operations hence boosted employment in Export Promotion Zones Authority (EPZAs). This shot to 35,000 people, with around 12,000 additional jobs created indirectly as a result of sub-contracting.⁷⁰

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The garment production accounted for approximately 17 per cent of total formal manufacturing employment in 2003, up from 3 per cent in 1999. Purchases by leading exporters from smallholders account for approximately 27 per cent of exported fresh vegetables and 85 per cent of exported fresh fruit. Homegrown, the country's leading horticultural producer uses about 1,000 out-growers. It operates a support policy for these out-growers providing them with seed, technical expertise and training to produce a high quality product.

⁶⁹ www.investmentkenya.com

⁷⁰ www.epzakenya.com

3.3 FDI and the Service Sectors

FDI in services has targeted tourism, financial, business services and telecommunications. Tour operators are dominated by foreign operators including United Touring Company, Express Travel, Abercrombie and Kent and Pollmans, which are all foreign owned. The largest projects are in the establishment of hotels and lodges for coastal and safari tourism. A number of the major international hotel chains are present, including Hilton, Intercontinental, Serena, Block Hotels and Holiday Inn. New trends have been timeshare holidays and ecotourism.

Kenya has also attracted FDI in banking and professional services. Companies such as Deloitte Touche, Tohmatsu and Ernst and Young base their main East African operations in Kenya. Thirteen of the 43 banks in Kenya are foreign, controlling 51 per cent of total banking assets in the country.

3.4 Source of Government Revenue

FDI and related investments by the very nature of their operations are bound to contribute to fiscal revenue for the host country. The buying of state corporations, private companies by foreign one helps in revenue generation. The continued operation of Chinese firms in local economy also guarantees income generation for the government in form of taxes and related activities.

3.5 Negative Effects of FDIs

Having enumerated the positive impacts of FDI on the economy, FDI is not without its negative results. The negative trends are threefold and include; the crowding out effect, the balance of payments problems of FDI and the enclaves economy created by FDI.⁷¹

On the crowding out effect of FDI basically refers to the potential 'taking away' of investment opportunities from the locals investors. On the balance of payments problems as a result of FDI, to the extent that profits are repatriated, they constitute a financial outflow that has to be set against net annual contribution of FDI inflows to a host country's balance of payment.

Finally, on the enclave economies created by FDI, it is said that FDI is often narrowly based with limited overall impact on host countries and benefiting only a small group of the population. There are two areas where such anxieties are expressed; the mining and other raw material extraction projects. Here investment is capital intensive and only a small fraction of the nationals are part of the workforce. This means few linkages exist, making their indirect impacts on the economy negligible.

Secondly, another example of the enclave economy is the EPZAs. With the amount of concessions and special privileges given for location in this zone, they exhibit limited linkages with the local economy. This is true in the case of Kenya.

⁷¹ Sun, Xiaolun, "Foreign Direct Investment and Economic Development. What Do States Need To Do?" (*Paper prepared for the Capacity Development Workshops and Global Forum on Reinventing Government on Globalization. Role of the State and Enabling Environment, Marrakech. Morocco, December 10-13, 2002*)

Many of the benefits of FDI are frequently challenged directly, both on ideological and empirical grounds. There is a common critique that foreign investors 'crowd out' local firms that cannot compete because of size, financing, marketing power, or some other unfair advantage.⁷²

A frequent grievance against foreign investment is that, although it promises capital inflows, in practice FDI can be a drain on foreign exchange. This is because foreign firms may be more likely to import materials.⁷³ Thus the larger picture that FDI does have some positive impact is well captured by literature.

In spite of this however, FDI remains a sure and reliable way of financing sustained economic growth over the long term. Ultimately, FDI becomes very central in eradicate poverty especially in developing world through economic growth and development.

⁷² Dunning, John. *Multinational Enterprises and the Global Economy*, (New York: Addison-Wesley, 1993).

⁷³ Chudnovsky, Daniel and Andres Lopez. *Globalization and Developing Countries: Foreign Direct Investment, Growth and Sustainable Human Development*, UNCTAD Occasional Paper, 2002.

CHAPTER FOUR: DATA PRESENTATION AND ANALYSIS

4.0 Introduction

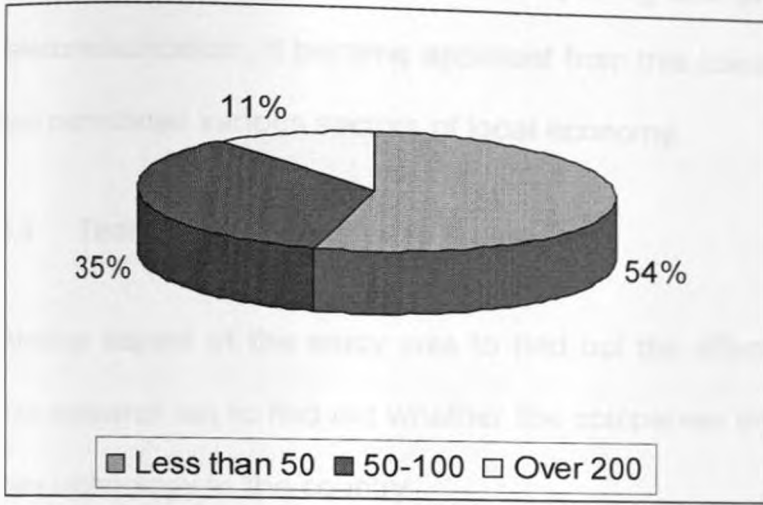
This chapter gives a detailed analysis of the data collected and presents the findings. The data has been analysed and presented in form of frequency tables, percentages and charts. Findings in this chapter demonstrate the objectives of the study, which included investigating the inflows of FDI from China to Kenya and identifying the main beneficiary sectors; evaluation of the extent and effects of FDI from China on Kenya's economic growth and to appraise the challenges that investors from China have encountered in establishing themselves in Kenya.

The researcher targeted to carry out the sampling process selectively. The researcher sought to identify those firms that have investments from China. The researcher sampled 80 firms managed get data from 38 firms with Chinese roots having administered questionnaire to over 100 of these firms.

4.1 Employment Creation

The research unravels the contribution of Chinese FDIs to Kenya's economy. In this respect the research sought to establish the number of jobs created through Chinese FDIs in the country. This is captured through data showing the number of employees in the companies involved in the study.

Table 4: Number of the Employees



The figure above shows that 54 per cent of the companies involved in the survey had less than 50 employees, 35 per cent had 50 to 100 employees while 11 per cent had over 200 employees. However the import of the statement is that the firms established in the country through FDI from China have created employment opportunity for the locals.

4.2 FDI and Business Sector

The paper found out that the sectors that have been target of FDI from China. To ascertain the beneficiary sectors of FDI from China, the companies involved in the study were categorised into the following business engagements: commercial agriculture and agro-processing, tourism, mining, development of service businesses, iron, steel and other metals, electronics and electrical equipment, building, construction and housing, training and health care.

Other businesses include: chemical processing, drinking water production, export of coffee, import and export of granite, importing and processing of farm products and telecommunication. It became apparent from this classification that Chinese investors had penetrated various sectors of local economy.

4.3 Technology Transfer to Kenya

Another aspect of the study was to find out the effect of FDI in technology transfer. The research set to find out whether the companies involved in the study had brought new technology to the country.

Table 5: Transfer of New Technology to Kenya

Response	Frequency	Per cent (%)
Yes	21	58.3
No	15	41.7
Total	36	100.0

Above table shows that 58.3 per cent of the Chinese companies involved in the study had brought new technology to the country while 41.7 per cent had not brought technology to the country. Examples of new technology brought into the country include; building of solar panels, CDMA for internet and telephone services, Chinese cooking, granite identification, growing mushrooms, interactive curricula, international airport renovation, introduction of new products, manufacture of bicycles, manufacture of intravenous fluids, packaging machines for tea and coffee, prepaid concept and wireless connection, PVC manufacture and quick processing of ballast.

Other forms of technology brought into the country include; relevant agricultural machinery, rice processing technology, traditional medicine, trendy spectacles, use of wax to make candles and waste management.

The areas of specialisation for the companies involved in the study were as diverse as the number of companies themselves. The areas of specialisation for these companies includes; beauty, candle making, coffee growing, communication, construction, electronics, engineering, export of coffee, GSM phones, health products supply, hotel business, housing and construction, imports, medicine and mining.

Other areas of specialisation include; multi-level marketing of food products, pharmaceuticals, plastics, processing maize, wheat and rice oil, processing of farm products, rubber recycling, running supermarkets, sale of bicycles and motorcycles, school education, spectacles, travelling promotions, water distribution and telecommunication services, water production and wine production.

Company activities were similar to their areas of specialisation and included; assembling of spectacles, importing of spectacles parts, building and estate development, building construction, buying and selling, creation of telecoms software, developing low budget housing units, environmental conservation, export of coffee and growing and marketing coffee.

Other company activities included; housing, building, import and export of granite, import of phones, distribution of import products, sales imports, manufacture of

cigarettes, multi level marketing of food products, running beauty parlour, training and travelling promotions.

4.4 Re-Export of China's FDI

China's FDI in Kenya has generated a new phenomenon in the export market. The Chinese firms in Kenya are gradually diversifying from local to regional and sub-regional market exportation. The paper establishes the target market for the products of Chinese FDI in Kenya. The respondents were asked to state the market for the companies' products and the results are listed in the table below.

Table 7: Products' Market

Market	Frequency	Per cent (%)
Local Market	22	61.1
Export	4	11.1
Both	10	27.8
Total	36	100.0

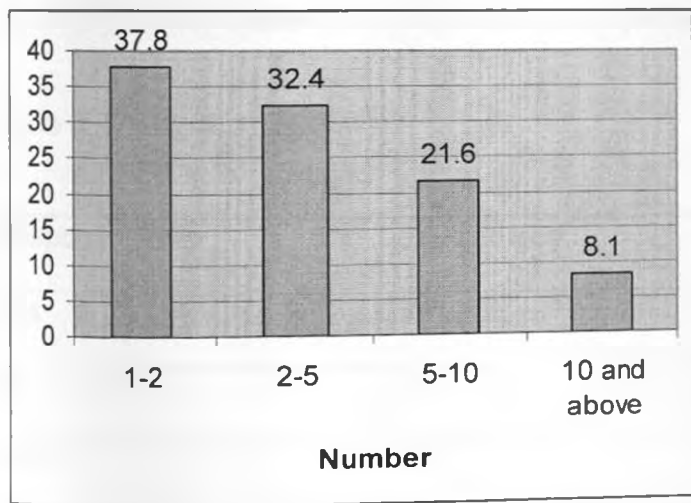
Majority of the companies involved in the survey comprising of 61.1 per cent distributed their products to the local market only, 11.1 per cent sold their products to overseas markets while 27.8 per cent sold their products both locally and internationally.

The observations made in this table point out that the Chinese FDI is important in increasing the revenue capacity of Kenya through export taxes and foreign exchange earning. This is positive for the economy to maintain a favourable balance of payment.

4.5 Number of Expatriates in the Country

This section sought to find out the number of expatriates brought into the country by the companies involved in the study when they first came into the country. The number of expatriates indicate the capacity building of human capital and at the same time it would be a source of undercutting the labour market for the locals.

Table 7: Number of Expatriates in the Country



The above graph shows that 37.8 per cent of the companies brought in 1 to 2 expatriates into the country when beginning operations, 32.4 per cent brought in 2- 5 expatriates, 21.6 per cent brought in 5 to 10 expatriates while 8.1 per cent brought in 10 and above expatriates.

The general view in regard to expatriates is that the Kenyan labour market is full of foreigners taking away the plum jobs in foreign firms at the expense of locally trained personnel. The Chinese firms under study have indicated that they hire expatriates that exceed two in number and others bring in the excess of ten. These figures create a scenario of Kenyans losing jobs to foreigners when the rate of unemployment is increasing. Positively, however, these expatriates interact with local staff and in the process pass skill and knowledge.

4.6 Training of Staff

The respondents were asked to state whether they had trained their staff, to handle new technology. This aspect is important in determining if the level of technology transfer is disseminated to the individual Kenyan workers in the organizations.

Table 8: Training of Staff

Response Rate	Frequency	Per cent (%)
Yes	34	91.9
No	3	8.1
Total	37	100.0

Majority of the companies involved in the study comprising of 91.9% had trained their staff to handle new technology while only 8.1% had not trained their staff. The observations that are made in the Chinese firms are that the level of technology transfer is high and the employees would be more competitive in service delivery not only locally but even internationally after getting exposure at work to new technology.

4.7 Provision of Technical Assistance

The researcher sought to find out whether the Chinese companies involved in the study had provided any form of technical assistance to their suppliers and customers. The results are tabulated below.

Table 9: Provision of Technical Assistance

Response rate	Frequency	Valid Per cent (%)
Yes	29	80.6
No	7	19.4
Total	36	100.0

Most of the companies involved in the survey, comprising of 80.6 per cent had provided technical assistance to their customers and suppliers while 19.4 per cent had not provided any form of technical assistance. The technical assistance to customers and suppliers is an effective approach to address the demand and supply needs of the Kenyans. The assistance would reduce the expenditures involved in trying to look for services to maintain and supply goods and product in a developing country like Kenya.

4.8 Conditions to Attract Chinese FDI in Kenya

The research paper finds out the prevailing investment environment in Kenya to attract investors from China. In the survey the respondents were asked to mention the various reasons that motivated their companies to establish their businesses in the country. These include; business opportunities, concern for environment, desire to

help heal stubborn diseases, development of Africa, expansion of their businesses, favourable trade relations, good investor environment, growth potential, huge market, and investment incentives.

Other motivating factors include; new business opportunities, new ventures, previous experience and ready market.

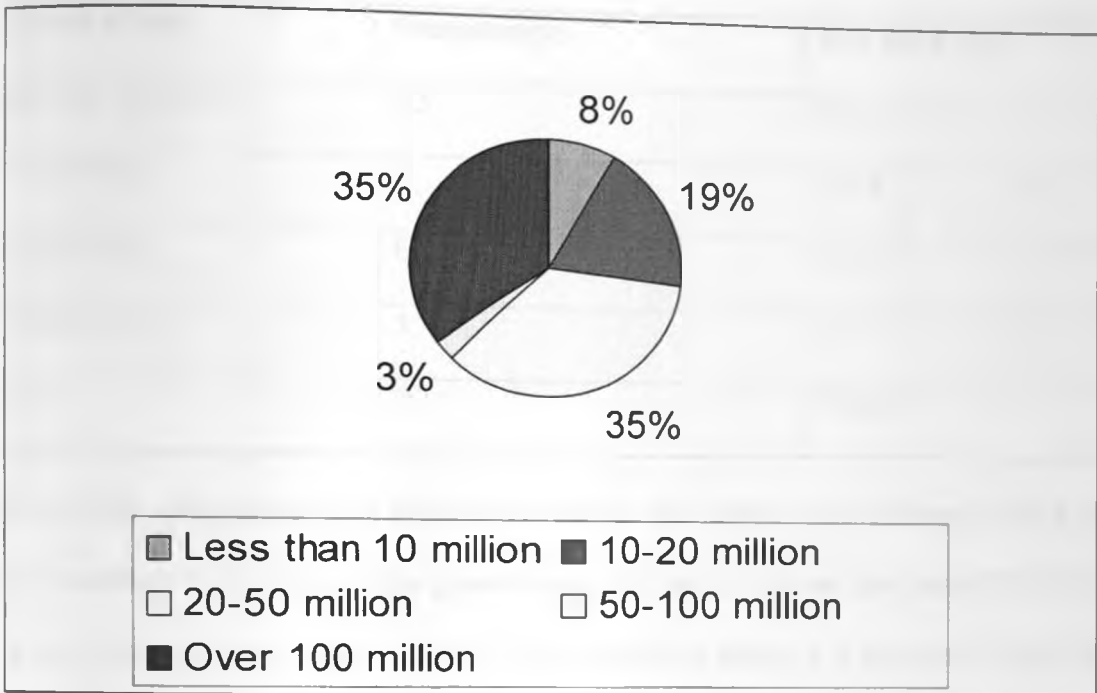
The respondents, however, mentioned challenges that their organisations experienced in setting up operations locally. On top of the list were language barriers, corruption and licensing. Other challenges experienced include; competition, getting a market niche, government bureaucracy, high set up costs, inadequate experienced local staff and legislation.

The Kenya investment environment was perceived by the Chinese firms to be conducive for business engagements.

4.9 Annual Sales Turnovers

The researcher sought to find out the annual sales turnover of the Chinese companies involved in the study to find out the contribution made in financial terms to government revenue and level of economic activity in Kenya. The results are as shown in the figure below;

Table 10: Annual Sales Turnovers



It can be seen from the above chart that 35 per cent of the companies involved had an annual turnover of over 100 million, another 35 per cent had an annual turnover of 20 to 50 million, while 19 per cent had a turnover of 10 to 20 million. Up to 8 per cent of the companies involved in the survey had an annual turnover of less than 10 million and 3 per cent had an annual turnover of 50 to 100 million.

4.10 Average Tax to the Government

This section sought to find out the average tax the companies involved in the study paid to the government. The government tax returns help the government continue supporting the development programmes. The results are tabulated below.

Table 11: Average Tax to the Government

Amount of tax	Frequency	Per cent (%)
Less than 10 million	23	62.2
10-20 million	5	13.5
20-50 million	8	21.6
50-100 million	1	2.7
Total	37	100.0

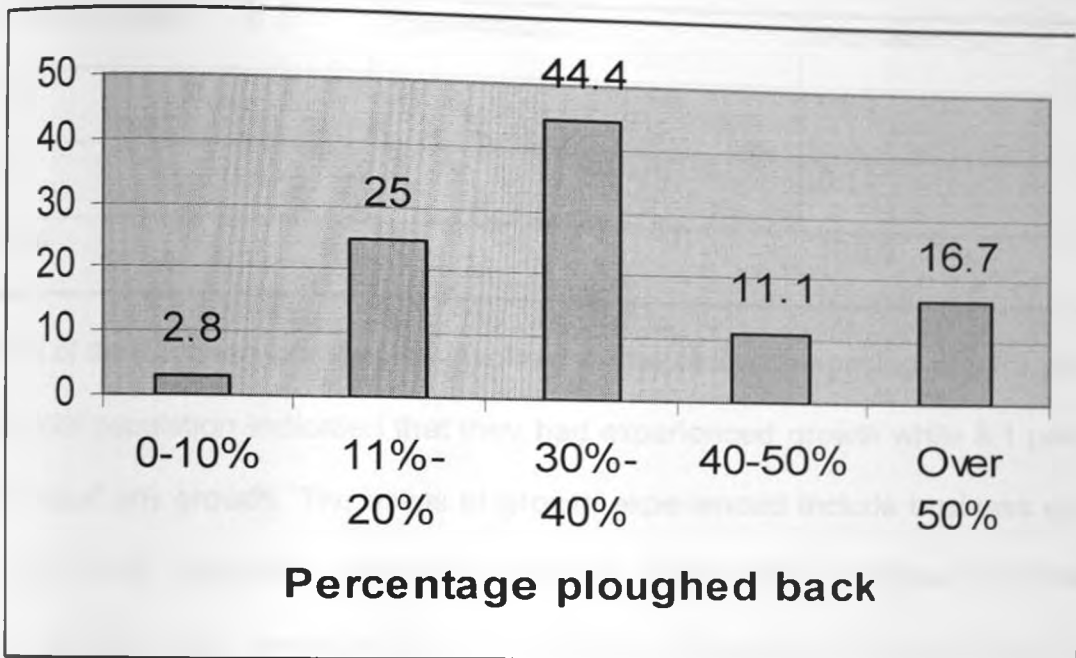
Most of the companies that were involved in the study, comprising of 62.2 per cent paid less than 10 million to the government as tax, 21.6 per cent paid 20 to 50 million as tax, 13.5 per cent paid 10 to 20 million as tax while 2.7 per cent paid 50 to 100 million as tax. The taxes paid by the companies involved in the study include; corporate tax, VAT, import duty and VAT, customs duty, excise duty, and service industry taxes.

The study reveals that the Chinese FDI contributes to Kenya's GDP and to the government revenue needs.

4.11 Percentages Ploughed Back to the Company

This section sought to find out the percentages of profits that the company ploughed back to the business to help expand the business serves. The percentages also indicate that the Chinese FDI does not only benefit the home company in profitability but it also expands the capacity to employ more locals and increase competitiveness in the market.

Table 12: Percentages Ploughed Back to the Company



It can be seen from the graph above that, 44.4 per cent of the companies involved in the study ploughed back 30 to 40 per cent of the profits back to the business, 16.7 per cent ploughed back over 50 per cent to the business, 25 per cent ploughed back 11-20 per cent while 11.1 per cent ploughed back 40 to 50 per cent back to the business. This practice promises continuity of these Chinese companies in Kenya and their investments.

4.12 China's FDI Growth in Kenya

The FDI from China to Kenya was investigated to find out performance and its general impact on Kenya's economic growth. The respondents were asked to state whether there had been any growth in the company since it was established in the country.

Table 13: Reported Growth

Response rate	Frequency	Per cent (%)
Yes	34	91.9
No	3	8.1
Total	37	100.0

Most of the Chinese companies involved in the study comprising of 91.9 per cent of the total population indicated that they had experienced growth while 8.1 per cent did not report any growth. The areas of growth experienced include business expansion, market share, deposits, distribution network, employees, increased business, sales volume and steady revenue base. The general observation from the firms is that the business performance had an effect on the local economy in terms of employment creation and revenue to the government.

4.13 Achievements of the Organisations

This section sought to find out the achievements of the organisations to determine if the economy derived competitiveness and growth. The data collected is tabulated below:

Table 14: Achievements of the Organisation

Achievements	Frequency	Per cent (%)
Superior efficiency in introduction of quality product	12	34.3
Innovation in the co-operative business	3	8.6
New technology successfully introduced	9	25.7
Social responsibility	2	5.7
Creation of superior values	3	8.6
Favourable competitiveness	6	17.2
Total	35	100.0

There various achievements that were reported include: superior efficiency in introduction of quality product, innovation in the co-operative business, new technology successfully introduced, social responsibility, creation of superior values and favourable competitiveness. All the respondents agreed that their organisations had long term policies and plans for using resources.

The achievements indicated above guarantee a predicable permanent location of the capital resources from China for a longer term. The continued stay of Chinese firms in Kenya give rise to stronger base of economy through human and capital formation.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

This study had three principal objectives. These were: evaluating how FDI flows from China to Kenya have impacted economic growth; exploration of any new technologies introduced to Kenya by Chinese investors and finally to appraise the challenges that investors from China have encountered in establishing themselves in Kenya.

To attract and enhance FDI inflows, a country needs to put in place a base of transparent, stable and predictable investment climate. This should be backed with proper contract enforcement and respect for property rights, embedded in sound macro-economic policies and institutions that allow businesses, both domestic and international, to operate efficiently and profitably and with maximum development impact.

Special efforts are further required in such priority areas as economic policy and regulatory frameworks for promoting and protecting investments, including the areas of human resource development, avoidance of double taxation, corporate governance, accounting standards, and the promotion of a competitive environment. Other mechanisms, such as public-private-partnerships (PPP) and investment agreements, are also important.

Kenya in the last decade has made huge strides to improve its economic environment. Special attention has targeted FDI with countries seeking to make enabling legal environment for this type of investment. This has led to improved economic performance with countries adopting structural adjustments aimed at pushing down

inflation and Government expenditures. FDI flows are influenced by factors such as growth and interest rates in the host country.

It is generally accepted that FDI is a key ingredient of successful economic growth and development in developing countries – partly because the very essence of economic development is the rapid and efficient transfer and cross border adoption of “best practices.” FDI is especially well suited to effecting this transfer and translating it into broad-based growth, not least by upgrading human capital.⁷⁴

In order to address issues of poverty reduction, growth is a necessary ingredient. Since growth can be fostered by FDI, it is central to the achievement of development for the countries of Africa and the developing world at large.

Does FDI then affect growth? It is a fact that positive FDI-growth linkage is not accepted without question. The general positive role for FDI in particular environments is however in no doubt. Three main channels through which FDI can bring about economic growth include the lessened constraint of domestic savings through foreign capital inflow. Here FDI augments low domestic savings in the process of capital accumulation.

Secondly, through FDI new technologies are introduced to the host country. The resultant effect of these technologies is increase in factor productivity and efficiency in the utilisation of resources, which leads to growth.

⁷⁴ Klein, Michael, Carl Aaron and Bitá Hadjimichael, “Foreign Direct Investment and Poverty reduction”, *World Bank Policy Research Working Paper #2613*, 2001.

Finally, FDI leads to increases in exports as a result of increased capacity and competitiveness in domestic production. FDI therefore has a big impact on economy and developing one like Kenya's.

FDI has inherent building blocks that would boost the economy of the host country. These building blocks include capital, technology, skills and management, market access, environment, competition, employment generation and revenue.

The role of FDI as a source of capital has become increasingly important not only because it can help to bridge the savings-investment gap, but also because it can provide needed resources for the attainment accelerated development. FDI brings into the host country financial capital which is normally scarce and hard to generate. The inflows are more stable, and are easier to service, than commercial debt or portfolio investment. Making it stand out from other sources of capital, FDI leads to foreign companies investing in long term projects, taking risks and repatriating profits only when the projects yield returns.

FDI capital in Kenya has elicited diverse impact. The auction of two mobile phone licences in 1999 and 2000 for example led to the rapid build up of infrastructure. The competition introduced in mobile telephony generated an increase in the availability and quality of services, with the number of users reaching three million in 2003 and mobile phone subscriptions to fixed line connections reaching a ratio of 6:1.⁷⁵

⁷⁵ www.investmentkenya.com

The main players in telecommunication are foreigners with sizable shareholding. These are in Safaricom (40 per cent owned by Vodafone) and Celtel of Netherlands (60 per cent).

On the other hand, the opening of the power generation sector to private investment in the late 1990s allowed the rapid increase in power supply. The award of to Independent Power Producer (IPP) contracts has attracted foreigners hence FDI.

Knowledge has been recognised as a foundation for competitiveness on firm and national level. Host countries, especially developing economies, aim to create indigenous "technological capabilities", that is "skills - technical, managerial and institutional - that allow productive enterprises to utilise equipment and technical information efficiently."⁷⁶

Developing world is known to lag in the use of technology. Most of the technologies employed would normally be obsolete and not keeping up to the ever changing technological trends. More importantly, the efficiency with which developing countries use given technologies is comparatively low. Even if part of their productivity gap is compensated for by lower wages, technical inefficiency and obsolescence affect the quality of products from these countries that then would not compete favourably in the global market.

Technological transfers take place mostly through transfers of managerial skills and processes and not so much through embodied technology. Formal research and development is low and is confined to a few large enterprises. The operations of

⁷⁶ Lall, S. *Learning from the Asian Tigers: Studies in Technology and Industrial Policy*, (London: MacMillan, 1996), p28

foreign enterprises in manufacturing are largely in the production of low-end consumer and agro-processed goods for the local and regional markets.

FDI has played an important role in introducing technology and knowledge in horticulture and floriculture in Kenya. This has enabled the sector to become a leading exporter of high-value products to the European market. In the flower production business, close to 90 per cent is controlled by foreign affiliates.⁷⁷ The success here therefore can be attributed to foreign investors. A Dutch company, Dansk Chrysanthemum and Kultuur (DCK), was the first to set up a large flower firm in 1969, with the benefit of government incentives and a Dutch government grant.⁷⁸

Many of its employees subsequently went on to play a role in other flower and vegetable companies. Brooke Bond of the United Kingdom also invested in a former DCK farm that became a major flower and vegetable firm. It was taken over by Homegrown in 2002 and renamed Kingfisher Farm. In the 1980s, Dutch investors formed the Oserian Development Company, which is now a leading horticulture player with 4,500 workers.

The growth in horticulture was favoured by spill-overs from the tourism sector. Ample space in passenger flights to Europe provided the essential cargo space for transporting fresh produce from Kenya at a time when volumes could not allow for cargo planes.

⁷⁷ UNCTAD, *World Investment Report 2002, Transnational Corporations and Export Competitiveness*. (New York and Geneva, 2002). P155.

⁷⁸ World Bank, *Kenya: Exporting Out of Africa –Kenya's Horticulture Success Story*. (Washington. DC. 2003).

The growing use of high-quality fruit and vegetables by local hotels and restaurants also gave farmers a boost in horticulture and an outlet for produce not meeting export standards.⁷⁹ The horticulture has been able to employ about 135,000 people as of 2003⁸⁰, compared with a total of 260,000 formal private sector agriculture and fishery workers⁸¹.

FDI has been at the root of transfers of skills to local workers. This has been possible due to the good trainability of employees given the relatively high level of general education. This is true as confirmed in these research findings which are presented in the next chapter.

Foreign firms often provided training to their employees on a wider basis. Many give more responsibility to local staff by providing ongoing training programmes. This allows the locals to take charge of top management positions and eventually run the firms even without any expatriate. Multinationals in the country are characterised as having only a few posts, often managing director and finance director, staffed by expatriates.

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New technologies introduced to the host country through foreign companies seeking investment opportunities would most likely raise the efficiency with which technologies are used. The technology in question would normally be adapted to local conditions, drawing on the experience from other parts of the world.

⁷⁹ McCulloch, Neil and Ota, Masako, *Export Horticulture and Poverty in Kenya*. IDS Working Paper 174, Sussex, 2002.

⁸⁰ World Bank, Kenya: *Exporting Out of Africa - Kenya's Horticulture Success Story*. (Washington, D.C, 2003).

⁸¹ Economic Survey 2004. www.un.org

A serious foreign company would go the next step and set up local research and development (R&D) facilities. The technologies are then upgraded as innovations emerge and consumption patterns change. All these are bound to stimulate technical efficiency in local firms, both suppliers and competitors by providing assistance, acting as role models and intensifying competition.

In the experience of Kenya, on technology and skills, FDI has given rise to more complex technology use or advanced processes in manufacturing in several firms such as General Motors and Tetrapak. Tetrapak has applied world class manufacturing techniques to its Kenyan operations since 2001 as part of a global programme.

The Dutch-owned Oserian flower company has installed one of the world's biggest geothermal heated greenhouses in order to reduce disease pressure and increase rose yield through more uniform temperatures.

Closely related to the technological aspect of FDI is the possession of human skill by the foreign employees. This is transferred to the local workforce by expatriates who are tasked to train potential officials to take over from them. This is mainly the case in the government so called build operate and transfer (BOT) arrangements. Most companies would set up training facilities that lead to local firms having qualified personnel. These companies would also introduce best management techniques, whose transfer to host countries offers enormous competitive benefits. Where affiliates are integrated into foreign companies' networks, they can develop capabilities to service the regional or global system in specific tasks or products.

The study found out that Chinese companies have targeted almost every single sector of the economy in Kenya for investment. These include agricultural, manufacturing, building and construction, health, communication and even tourism. The amounts invested have too not been very small either. Of the companies surveyed up to half reported having invested over Kshs. 20 million and most of these indicated they ploughed back up to 50 per cent of their projects.

It is also on records that Chinese investors in Kenya have introduced one form of new technology or another. Of the companies polled over 58 per cent indicated they had introduced new technology including building of solar panels, CDMA for internet services and telephony and manufacture of assorted products. At the same time these companies reckon that they found the type of labour they sought when they started operation in the country. This phenomenon is indicated by the fact that up to a third of these companies brought in between 1-5 expatriates. All the companies polled indicated they had found desired staff on coming to Kenya.

Chinese companies say they have invested in the country because of the business opportunities that Kenya presents and a desire to expand their business beyond their borders. They confirm that they have indeed enjoyed business growth including very welcoming and accommodating business environment.

The investment by Chinese companies has not been without challenges. The biggest challenge that cuts across all the companies surveyed is language barrier. Indeed even when seeking for information for the purpose of this study, the biggest challenge was language.

In some organisations we gave up after failing to communicate even on the initial explanation of the mission. Other challenges include corruption and licensing. Most of these companies reported to encountered demand for bribes especially at licensing points both for business and work permits for expatriate staff. The set up cost were generally deemed to have been of the higher side especially having exceeded initial projected levels.

On the whole it can be observed that Chinese companies have helped the Kenyan economy to grow. The overall impact is hard to measure because of the difficulty in accessing data and secondly not all companies that have invested locally have registered with the Kenya Investment Authority. Although the amounts invested look small, the numbers of companies which we estimate to be in the region of 300 and above eventually makes the impact that is felt in the economy.

Yes Chinese companies have made a contribution to the economy of Kenya but more research need to be done and more data collected to determine the actual level of this impact. This research is therefore by no means conclusive and only makes a scratch on surface on what would otherwise be a bigger field of study and investigation by scholars.

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<http://www.granta.com/extracts/2616>

APPENDIX 1: List of Companies Involved in the Study

1. Afri China International Co. Ltd
P. O. Box 34101-00100
Nairobi
Tel. 0722712249
2. Beinparts Ltd
P. O. Box 9396-00100
Nairobi
Tel. 230658
3. Boleyn International Ltd
P. O. Box 18859, Nairobi,
Tel. 537686/7, Fax 651072
4. Changhong Electronics
P. O. Box 10348-00100,
Nairobi
Tel 821109
5. Hgy International Co. Limited
P.O. Box 47662
Nairobi
6. Chengdu Guangling Kenya
Co. Ltd
c/o Nairobi, Kileleshwa
Tel. 4343580, Fax. 4343580
7. China Agricultural Technology Co.
P. O. Box 41374-0100,
Nairobi.
Tel. 2726960
8. China Farm Products
P. O. Box 49368,
Nairobi
9. China Binzhou Chunchai
Marsh Gas Co. Ltd
Box 54382-00200
Nairobi
10. Lulu Development Co. Ltd
P. O. Box 54948-00200
Nairobi
Tel. 0733-353336
11. China King Restaurant
P. O. Box 51381-00200
Nairobi
Tel. 0722-511868, Fax. 020-
3740876

12. Newstar Ltd
P. O. Box 9151-00100
Nairobi
Tel. 0722-230539
13. Lucky House International Ltd
P. O. Box 21594
Nairobi
Tel. 0725-530915
14. Henan Company (K) Ltd
P.O. Box 41374
Nairobi
Tel. 2712315
15. Erdemann Property Limited
P. O. Box 42541
Nairobi
Tel. 6763981, Fax. 6765473
16. Erdemann Co (K) Ltd
P. O. Box 42541-00100
Nairobi
Tel. 6763981, Fax. 6765473
17. Wu yi Kenya Company Ltd
P. O. Box 49282-00100
Nairobi,
Tel. 2735091, Fax. 2730344
18. Datang Optical Company
P. O. Box 54998-002000
Nairobi
Tel. 0724-969999
19. Horizon Ivato Supermarket
Ltd
P. O. Box 10793-00100
Nairobi
Tel. 2731158, Fax. 2731149
20. Focus Motorcycle
Manufacturing Co Ltd
P. O. Box 15182
NAIROBI
Tel. 0734-145835
21. Go Africa Travel Ltd
P. O. Box 10793-00100
Nairobi
Tel. 020-2719988, Fax 020-
2728546

22. Gold Lida Ltd
P. O. Box 10340-00100
Nairobi
Tel. 248800, Fax. 240888
23. Greatland Pharmaceutical Ltd
P. O. Box 8262-00100
Nairobi
Tel. 3748770, Fax 3741511
24. Henan Company (K) Ltd
P.O. Box 41374,
Nairobi
Tel. 2712315
25. Kenya AA Electric Crane
Company
P. O. Box 5268-00506
Nairobi
Tel. 0735-741589
26. Huawei Communications Ltd
P.O Box 66430-00800,
Nairobi, Kenya
Tel: 2730168, Fax: 2730160
27. Kenplastics Ltd
P. O. Box 519-00202
Nairobi
Tel. 0722-710258
28. Newland Industries Ltd
P.O Box 52900
Nairobi
29. Peng and Huo Medical
Company
P.O. Box 1521-00200
Nairobi
Tel. 0722-820412
30. Chinese School Kenya Ltd
P. O. Box 47662-00100
Nairobi
Tel. 2719988, Fax. 2728546
31. Super Beauty Parlour Ltd
P. O. Box 41374 -00100
Nairobi
Tel. 212315

32. Tasly Africa (Kenya) Ltd

P. O. Box 3302-00200

Nairobi,

Tel. 0722-867075

33. Telegance Kenya Ltd

Box 52094-00200,

Nairobi

Telefax. 244915

34. Sinotec (Kenya) Ltd

P. O. Box 63439-00619

Nairobi

Tel. 0733-740978, Fax.

3766895

35. Tianshi Health Products

P. O. Box 6626

Nairobi

Tel. 0722-973220

36. Nippo Supplies Ltd

P. O. Box 47950-00100

Nairobi. Tel. 604166

37. Xianghui (k) Co. Ltd

P. O. Box 60252-00200

Nairobi

Tel. 0727-287666, Fax.

557050

38. Xin Yuna Construction

Investment Ltd

Construction Investment Ltd,

c/o Nairobi, Kenya

Tel. 0724-839922

APPENDIX 2: Questionnaire

Section A- GENERAL BACKGROUND INFORMATION

1. Title of the respondent _____ (Optional)
2. What is the name of the company? _____
3. What are the terms of incorporation of your company?
 - a) Local Foreign Partnership
4. Where is your company incorporated
 - Kenya China Other (Specify).....
5. How many years has your organisation has been operating in Kenya
 - a) Less than one year 1-5 Years
 - b) 6-9 Years Over 10 Years
6. How many employees has your organisation engaged?
 - Less than 50
 - 50 – 100
 - 100 – 150
 - 150 – 200
 - Over 200
7. How spread are your clients in terms of area covered in your distribution?

Only in Kenya Only in East Africa countries

All parts of the worlds

8. In which sector is your business involved in

- a. Commercial agriculture and agro-processing
- b. Tourism
- c. Mining
- d. Infrastructure development
- e. Development of service businesses
- f. Privatisation
- g. Textiles and apparel
- h. Iron, steel and other metals
- i. Vehicle parts and assembly
- j. Electronics and electrical equipment
- k. Building, construction and housing
- l. Training
- m. Health care
- n. Financial services

o. Other (Specify) _____

9. List the type of goods or services you provide? _____

Section B

10. Have you introduced any new technology into Kenya?

- Yes No

11. Give example of the technology.....

12. What is your specialisation?

13. List some of the activities your company has been involved in Kenya.

- a)
- b)
- c)

14. Your products are mainly for:

Local Market Export Both

15. How many expatriates does your organisation have in Kenya?

1-2

2-5

5-10

10 and above

16. Did you get quality of desired staff when you set up in Kenya?

Yes No

17. Have you trained any of your staff in handling any new technology?

• Yes No

18. Have you provided any form of technical assistance to suppliers or customers?

▪ Yes No

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19. What motivation did you get to establish company in Kenya

20. What challenges did you face when setting up operations locally?.....

21. Approximately how much was spent in setting up the organization

- Less than 10 million
- 10-20 million
- 20-50 million
- 50-100 million
- Over 100 million

22. What is the relative size of your company in terms of annual sales turnover?

- Less than 10 million
- 10-20 million
- 20-50 million
- 50-100 million
- Over 100 million

23. What is the average tax that you pay the government?

- Less than 10 million
- 10-20 million
- 20-50 million
- 50-100 million
- Over 100 million

24. What taxes are applicable to business entities in Kenya?.....

25. What percentages do plough back to the company?

- 0% - 10%
- 11% - 20%
- 30% - 40%
- 40 - 50 %
- Over 50 %

26. Have you experienced any growth since the organisation was established locally?

- Yes No

27. If you answered yes above, please state the areas of growth.....

28.What are some of the achievements of your organisation since the time it has been in operation?

- (a) Superior efficiency an introduction of quality product ()
- (b) Innovativeness in the co-operative business ()
- (c) Social responsibility ()
- (d) Creation of superior values ()
- (e) Favourable competitiveness ()

Other (specify).....

29.Do you have long term policies and plan for using the resources of your organisation to support the growth of the host nation?

Yes

No

Thank you for your co-operation