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China-Egypt trade and investment ties – seeking a better balance

This policy brief examines Chinese investments in Egypt and the bi-lateral trading relationship between the two countries in order to better understand the extent of economic engagement. Since 2013, a spur in high-level diplomatic exchanges led to the signing of numerous agreements, including a Comprehensive Strategic Partnership agreement. Promises of Chinese foreign direct investment (FDI) into large-scale transport and energy infrastructure projects have been cited. With the trade balance heavily tipped in favour of China, this policy brief identifies ways for Egypt to more broadly benefit from the relationship.

Port and rail transport infrastructure

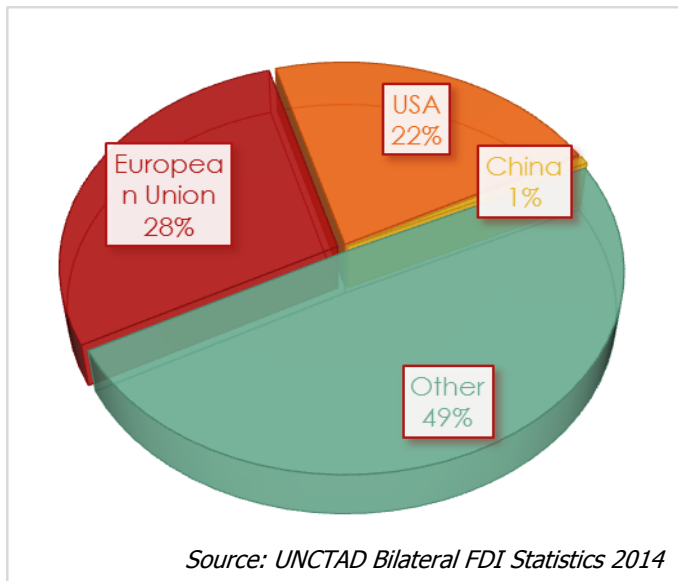
Chinese companies view Egypt as a business environment with potential. Egypt's long maritime coast, and economic reforms undertaken in the 1990's towards privatisation, including guarantees on foreign investment, and notably in the maritime sector, make Egypt an attractive partner. Significant Chinese investment has been directed at Egypt's port infrastructure with the debut investment in 2005 being made by Hutchison Port Holdings (HPH), a subsidiary of Hong Kong based Hutchison Whampoa. It acquired a 50 per cent share in a joint venture with Alexandria Port Authority to construct, operate, and manage two container terminals in the ports of Alexandria and El Dekheila on Egypt's northern Mediterranean coast, although the amount invested was not publicly aired. In 2008, COSCO Pacific, China's largest state-owned shipping company acquired a 20 per cent share in a joint venture to operate and manage the Suez Canal Container Terminal in Port Said East Port. China Harbour Engineering Company (CHEC), a subsidiary of state owned China Communications Construction Company (CCCC) which comes under the supervision of the State Council, constructed quays in Port Said East Port and al-Adabiya port.

A previously announced US\$ 416 million investment for a cargo terminal, to be established jointly with Saudi Arabia, and also in al-Adabiya port, has been delayed as CHEC searches for alternative financing. Additionally, although no agreements have been signed so far, China's diplomatic mission has expressed support for the construction of tunnels (reported as two road-

and one railway-tunnel) underneath the Suez Canal. Benefits for Egypt include modern infrastructure and facilities as well as an increase in port capacity.

Staying in the transport infrastructure sector, following Egyptian President Abdel Fattah al-Sissi's visit to China in December 2014, an initial agreement was signed by Egypt's Transport Ministry and CHEC for a high-speed train line covering the 900 km distance between Egypt's Mediterranean city of Alexandria and Aswan, close to the border with Sudan. At the economic feasibility stage, the total cost was estimated at US\$ 10 billion inclusive of US\$ 3 billion for the first stage from Alexandria to Cairo. Providing direct and spin-off local employment opportunities, Egypt will supply local materials, executive oversight, and 20 per cent of the labour. Therefore, the majority of workers directly employed will be Chinese. In 2014, a Memorandum of Understanding (MoU) and a preliminary agreement were signed to develop an 80 km electric railway from El-Salam City to Belbeis and Sharqeya in greater Cairo. The players involved include Egypt's Ministry of Transportation and the Aviation Industry Corporation of China (AICC), a state-owned aerospace and defence company. The cost of this project is estimated at US\$ 1.5 billion, and will take three years to complete. It will be financed by China through loan repayments due over a 20-year period. The rail line is expected to carry 52 million passengers annually. Given Egypt's cumbersome traffic congestion, these projects will alleviate the stress of long daily commutes in Egypt and add available hours

Chart 1: Egypt's FDI inflows and instocks for 2012



for productivity to the wider economy. Yet, they ultimately demonstrate China's push to increase its market share in transport infrastructure projects overseas and its desire for a strategic partnership with Egypt despite the delays and challenges.

Energy: electricity supply, oil and gas

The energy sector is also emerging as an important area of co-operation in China-Egypt relations. In December 2014, upon President Sissi's visit to China, the two countries signed a Comprehensive Strategic Partnership Agreement alongside a MoU between Egypt's Ministry of Scientific Research and China's Ministry of Science and Technology to establish a joint laboratory for renewable energy. Faced with regular power outages and growing energy supply needs, the move comes as part of Egypt's energy diversification strategy, particularly towards renewable sources of energy supply. The next step forward came during Egypt's March 2015 Economic Development Conference, which aimed to attract foreign investment. The State Grid Corporation of China signed an US\$ 1.8 billion agreement with Egypt's Electricity Transmission Company to upgrade Egypt's dilapidated grid infrastructure. Although prioritised by Egypt's Ministry of Electricity and Energy, this project has not yet come to fruition.

Additionally, Chinese companies seem set to have a presence in Egypt's solar energy market. In 2015, Yingli Solar, one of the largest solar panel manufacturers in the world, also signed a MoU with Egypt's Ministry of Electricity and Energy for development of a solar energy plant. Yingli Solar will construct the plant and provide loan financing, while the Ministry will provide the land and "other convenient conditions". The target is

to add 500 MW of solar photovoltaic capacity to the electricity supply in three years. Protests resulting in violence between local communities and the state's security forces, and court cases investigating heads of ministries over the sale of land to foreign investors are not uncommon in Egypt. Therefore, the Ministry needs to ensure availability of adequate compensation if families are to be displaced, and to include local communities in the project so that all stakeholders benefit.

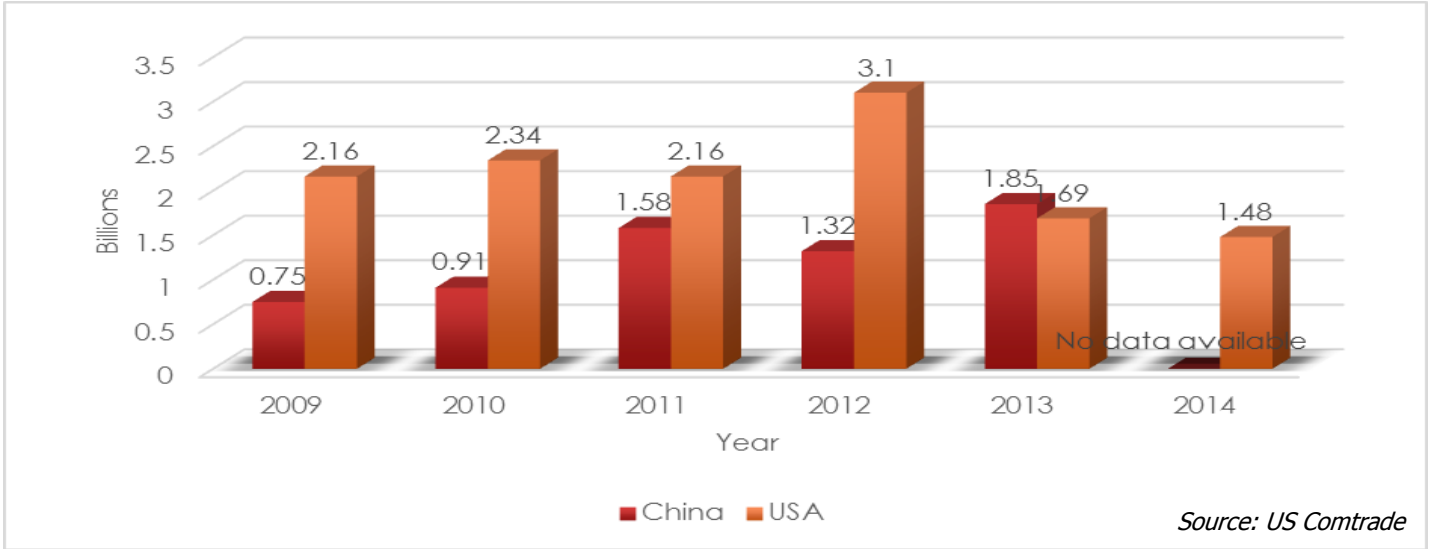
Also, Egypt's oil and gas sector has benefited from Chinese national oil companies' growing presence in international energy markets. Adding to its existing Egyptian portfolio, in 2013, state-owned China Petroleum & Chemical Corporation (Sinopec) acquired a 33 per cent stake in the Egyptian operations of Apache, a US exploration and production company active in Egypt's Western Desert. Total capital investment requirements for the year figured at US\$ 1.1 billion. Along the Gulf of Suez, Chinese companies are making headway in the downstream sector. In 2010, Egypt's Ministry of Petroleum signed agreements with Rongsheng Holding Group and the China National Chemical Engineering Company for a US\$ 2 billion joint project to construct a refinery on the property of the Al-Nasr Petroleum Company in Suez city. Although construction is yet to start, if realised, it would boost Egypt's refining capacity and reduce its reliance on imported petroleum products.

Within the China-Egypt Suez Economic Trade & Cooperation Zone (SETC-Zone), an area has been dedicated to the manufacturing of petroleum equipment ranging from drilling rigs to components. In 2015, the International Drilling Materials Manufacturing Company, established under the supervision of the Egyptian Ministry of Petroleum, and 40 per cent owned by Star Oil & Gas (SOG) of China supplemented its existing investments in the area. The addition from SOG was a US\$ 250 million investment to establish a seamless pipe rolling mill to supply the entire African market, which demonstrates that Chinese companies plan to use Egypt as a hub to branch into other markets. Chinese companies are stepping into a market traditionally dominated by western oil majors and creating new areas of cooperation with Egypt in the field of renewable energy supplies.

Chinese Foreign Direct Investment (FDI)

Going beyond specific investments, it's necessary to consider the determining factors and emerging trends of Chinese foreign direct investment (FDI) into Egypt. Similar to many African countries, Egypt has been actively seeking Chinese investment, viewing it as an alternative to the hard-hitting conditions often attached to western investment. In August 2013, former President Morsi's three-day visit to China reportedly resulted in investment agreements totalling US\$ 4.9 billion and President al-Sissi's December 2014 visit produced 26 agreements including

Chart 2: Imports from Egypt



eight in transportation, thirteen in electricity, three in tourism, and two in the supply field, worth a combined value of US\$ 60 billion. In December 2014, the Egyptian-Chinese Business Council, a non-profit organisation whose purpose is to boost trade and investment between the two countries, signed four agreements valued at a further US\$ 250 million.

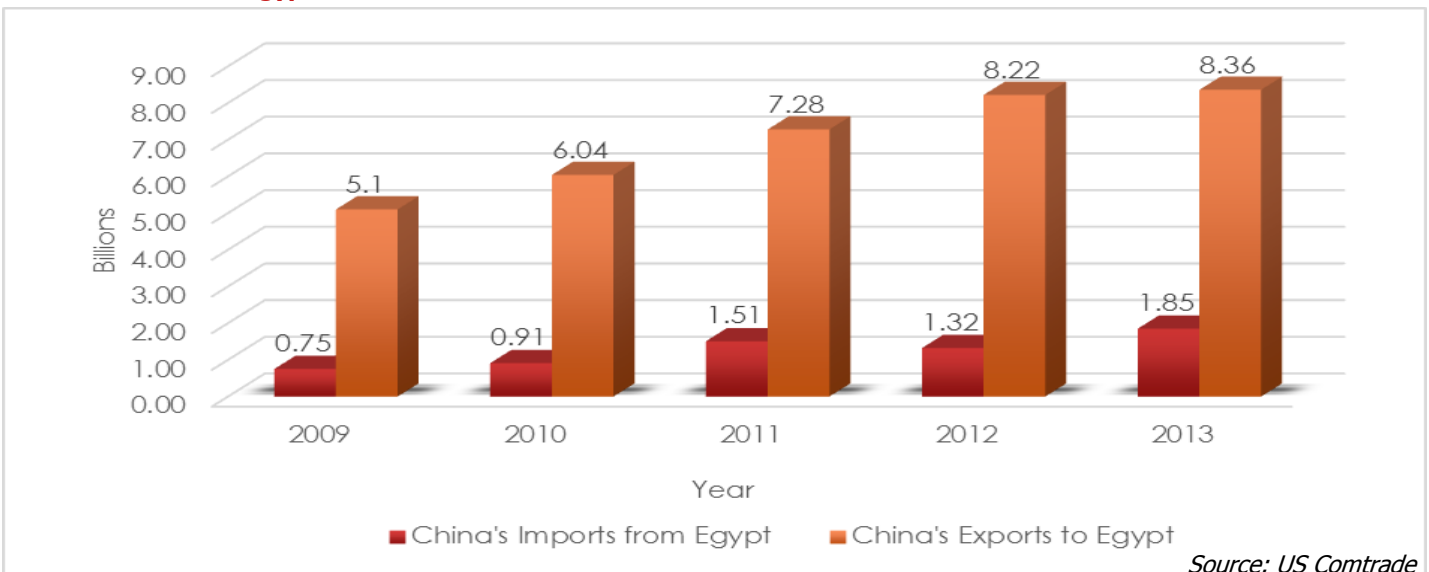
Yet, if we look at actual Chinese FDI into Egypt in recent years, the results in comparison to those of the European Union and the USA are insignificant. As shown on the pie chart below, Chinese FDI into Egypt in 2012 (2013 and 2014 figures have yet to be finalised) represented a mere one per cent of overall FDI. Three realities explain these results. Firstly, the European Union and the USA continue to view Egypt as strategically important and as having huge market potential. Therefore, their investment interests will not change in the short-term. Secondly,

many of the agreements signed with China constitute MoUs signifying early stage negotiations rather than actual investment commitments. Thirdly, committed investment is spread out over a number of years, therefore promises made now may not be fully realised until sometime into the future. Thus, if China fulfils its promises, we could expect Chinese FDI to increase marginally in the coming years, although it seems unlikely to bypass in the foreseeable future FDI coming from Western countries.

The trade imbalance

The long-term trajectory of the relationship can also be determined by examining bi-lateral trade. We can compare 2014 figures to those in the 1980s when China and Egypt initially agreed to trade in foreign exchange. In 1987, total bi-lateral

Chart 3: China-Egypt bi-lateral trade



trade between the two countries was valued at a mere US\$ 135 million of which US\$ 125 million accounted for Chinese exports to Egypt while only US\$ 10 million accounted for Egyptian exports to China. The value of bi-lateral trade for 2014 is expected to be finalised at US\$ 11.5 billion, which would represent a 96 per cent increase over the 5-year period, 2009 to 2014, when bi-lateral trade amounted to US\$ 5.86 billion.

Expectedly, the majority of this increase over time is accounted for by Chinese exports to Egypt. Despite a thirteen per cent year-on-year decrease experienced in 2009 as a result of the financial crisis, by 2010, Chinese exports to Egypt had made an eighteen per cent recovery according to 2008 figures. As Chart 2 indicates, in subsequent years, China's exports increased sharply, reaching US\$ 8.3 billion by 2013. In addition, China's imports from Egypt have been increasing over the last five years, going from US\$ 752 million in 2009 to US\$ 1.85 billion in 2013.

To provide these figures with additional context, we can compare them with those of the USA. In 2012, China bypassed the USA as Egypt's top trading partner. Similar to China, US exports to Egypt decreased by approximately thirteen per cent year-on-year during the global financial crisis of 2009. They decreased further from US\$ 6.8 billion in 2010 to US\$ 5.2 billion in 2013. Traditionally, the US has represented a much larger export market for Egypt than China. However, for the first time, in 2013, China's imports from Egypt inched passed those of the USA, and on the whole, US imports from Egypt have decreased over the last five years, with neither exports nor imports to or from Egypt sustaining growth.

While the growing China-Egypt trade relationship is clear, the trade imbalance present since the 1980s has worsened significantly over time. This imbalance can partly be explained by each country's population size as a contributing factor toward gross domestic product (GDP), and partly by the types of products being exported. Chinese exports to Egypt, while mass manufactured, are value added products, whereas China's imports from Egypt mainly consist of primary commodities and light industry products. The growth in Chinese exports to Egypt is, on the one hand, a realisation of China's long-standing objective to develop export markets abroad (where Egypt is currently China's largest export market in North Africa) and, on the other hand, is symbolic of China's growing trade surplus worldwide. Consequently, Egypt may become more dependent on China as an export market than vice versa over the long term. Without determined corrective action, the trade imbalance seems set to worsen and distort further Egypt's overall trade balance.

Conclusion

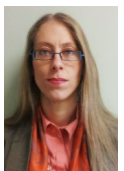
As China and Egypt have increased their diplomatic exchanges and strengthened institutional ties over time, business partnerships and trade relations have also progressed. That said, if the China-Egypt relationship is to reach its full potential, and bring much needed benefits to Egypt, China's promised investments will need to be realised in full. While the trade dynamics traditionally in favour of the USA appear to be shifting, it is important not to overestimate the China-Egypt relationship. China remains a recent and relatively small player in the overall Egyptian economy. European Union member states, Turkey, and the Gulf countries remain by far more important trading and investing partners for Egypt.

Recommendations

- Chinese companies in joint ventures with Egyptian companies should provide a good balance of employment opportunities for Egypt's trained and educated workforce, rather than merely employing unskilled Egyptian labourers. Such a balance would include access to mid-managerial positions and training in new technical areas.
- China should ensure that it maintains its investment commitments to Egypt particularly in the fields of rail transport and electricity supply in order for Egypt to benefit from the relationship. For its part, Egypt should seek to improve the business environment by taking into consideration the interests of local communities in order to avoid opposition and potential legal disputes surrounding the profit-making interests of Chinese businesses as foreign investors.
- China and Egypt should agree at the political level to take determined action to correct the trade imbalance. Such action can include China committing to help Egypt to move up the value added product chain through joint production of goods of interest to the Chinese market.

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