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From Contractors to Investors? Evolving Engagement of Chinese State Capital in Global Infrastructure Development and the Case of the Lekki Port in Nigeria

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POLICY POINTS

Chinese companies have been seeking to **climb up the value chain by becoming investors and operators** of the infrastructure projects they are contracted to build.

Despite their prominent market share in Africa as contractors, **Chinese companies face a steep learning curve** and have sought to work with other international actors from advanced economies.

The industry's willingness to upgrade can harness a **move away from** China's lending practice that is overly reliant on **sovereign loans.**

Host governments need to be realistic about the **capabilities** of Chinese companies as investors and operators, and push for **localization and skill transfer.**

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WILL CHINA CONTINUE TO FINANCE GLOBAL INFRASTRUCTURE development in the same way it used to? As the world, and especially China itself, re-emerges from the COVID-19 pandemic, the answer to this question will shape the global political economy of development in the years to come. Drawing on my research on the Chinese infrastructure construction industry and a case study of the Chinese-invested Lekki Port in Nigeria, this policy brief argues that the Chinese financing model is likely to change as required by the evolving needs of China's infrastructure industry, specifically their desire to move up the value chain. However, Chinese state-owned enterprises (SOEs) and financial institutions face a steep learning curve in their attempt to upgrade and may still rely on collaboration with other international actors. Understanding these dynamics within the Chinese industry helps policymakers accurately assess the outlook of China's overseas finance.

SEEKING UPGRADE

CHINA'S DECLINING LENDING TO OVERSEAS infrastructure development is by now well known. Boston University's Global Development Policy Center data shows that overseas lending by China's two main policy banks further shrank in 2021 to 4.3 percent of its peak level in 2016.[1] Such a sharp decrease of Chinese overseas lending coincided with the COVID-19 pandemic, but changes had already been underway since much earlier. Since at least 2015, Chinese policymakers, industry, and financial institutions have been actively discussing diversifying from Engineering-Procurement-Construction Plus Financing (EPC+F), the model responsible for fueling the global expansion of China's infrastructure industry and main driver of China's lending in this sector. They started to promote a model called "integrated investment, construction, and operation" (IICO, 投建营一体化).

IICO envisages the Chinese companies to extend their service to both the upstream and downstream components of the project life cycle: not only would they work as contractors for the construction of infrastructure projects, but they would also take responsibility in the operation; to be awarded such rights to operate often requires the company to contribute equity investment, so that long-term operational needs

could already be planned during the project conceptualization stage. Simply put, IICO would involve Chinese companies taking greater "ownership"—in both meanings of the word—in the overseas projects they build. IICO was quickly adopted in China's policy discourse, for example as mentioned in China's 2021 white paper on China-Africa relations as an aim for the transformation of China-Africa infrastructure cooperation.[2]

Several factors contributed to this call for IICO. First, Chinese financial institutions sought to hold construction companies more accountable. In the past EPC+F model, companies were overly focused on securing contracts without being liable for the projects' long-term viability. Having companies taking a stake in the projects they build is expected to incentivize prudence in project initiation and construction quality. Second, the industry also realized that they need to move up the value chain, as EPC contracting is low value-added, and their cost advantages are being eroded, while project development (investment) and operation are considered the goal of upgrading, drawing inspirations from global industry leaders. Third, the past EPC+F model mostly involved sovereign loans—countries borrowed from Chinese banks to pay for services provided by Chinese companies—but many countries have become too indebted to borrow more. The Chinese industry needs an alternative financing model to support their overseas expansion.

IICO can be considered a kind of foreign direct investment targeting greenfield infrastructure development, motivated specifically by the pursuit of export markets for its contracting services. Potentially, it could help with moving away from the sovereign loan-dominated lending practice, and instead have the investing (Chinese) companies assume the debt as part of project financing. But it is also possible that such risks are too great for China's state capital actors to handle.

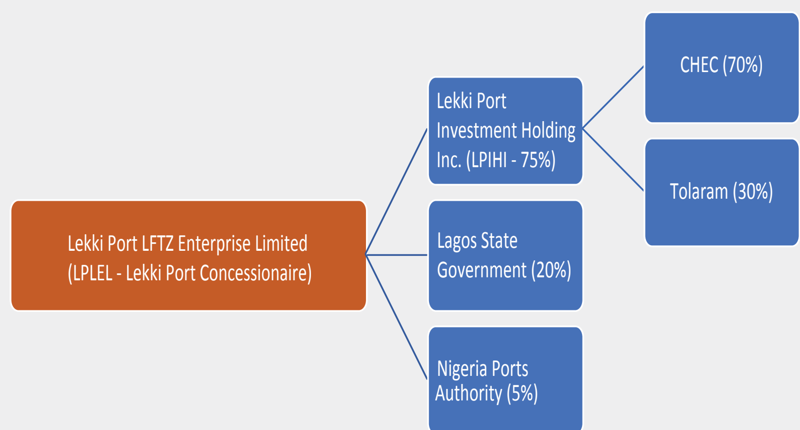
Contrary to the common impression that Chinese state capital is more risk-tolerant, Chinese SOEs and banks are in fact rather conservative in their risk management: Chinese banks often require the outward investor to provide guarantees for the loans for their overseas projects, which would add to the company's financial liability; Chinese SOEs in the infrastructure construction sector are typically already highly indebted and thus reluctant to provide the kind of guarantees banks require.[3] Moreover, since 2016, Chinese SOE leaders have been held accountable for the lifetime of any outward investment decisions they made during their tenure, which is also holding many back from pursuing risky overseas investment. Due to these reasons, the shift toward IICO has been slow, especially in Africa where investment risks are high.

LEKKI PORT CASE

APART FROM THE ABILITY TO handle risks, Chinese companies are also limited by their narrow expertise to move to the higher value-added positions, as my case study of Lekki Port reveals. The US$ 1.5 billion Lekki Port is one of the few IICO projects so far conducted by a Chinese infrastructure construction company in Africa. The investor of the project is China Harbour Engineering Company (CHEC), which has built at least 13 ports in Africa and established itself as a dominant player in its port construction sector. CHEC's parent group, China Communications Construction Corporation (CCCC), is among the world's top five international contractors, and the largest from China. CCCC was also selected as a pilot among China's construction SOEs to test out new state capital management methods, which gave it greater autonomy in outward investment. Therefore, CHEC and CCCC can be considered the most capable among Chinese infrastructure construction companies to conduct IICO-type of investment. But even for them, the realization of IICO in Lekki Port has critically depended on the collaboration of other international actors.

CHEC only became an investor in Lekki Port after its original developer—the Singaporean company Tolaram Group, a consumer goods company well established in Nigeria—failed

Figure 1: Lekki Port Shareholding Structure



Sources: Author's fieldwork, June-July 2022.

to secure financing for the project from European and Nigerian banks. In this context, CHEC, originally hired by Tolaram as the EPC contractor in 2012, started approaching Tolaram about providing equity investment in 2017. Eventually, they agreed on a 70-30 split in the joint venture (JV) with CHEC taking the majority, and this JV in turn holds a 75 percent stake in the concessionaire responsible for developing Lekki Port—together with Lagos State government (20 percent) and the Nigerian Ports Authority (five percent) (Figure 1).

CHEC's decision to invest in the Lekki Port is only justified if it can profit from the port's operation. As experienced as CHEC is in port construction, it has close to no experience in port operation. Meanwhile, the Nigerian partners and Tolaram also demanded operation to be separated from CHEC's control for the sake of balance. This was how CMA Terminals (CMA hereafter), subsidiary of the French shipping conglomerate CMA-CGM, came into the picture. Already having a significant market share in Nigeria as a terminal operator, CMA will take 80 percent stake in the JV with CHEC that will operate Lekki Port. Importantly, CMA's guarantee of port traffic helped convince CHEC's leaders to greenlight the investment. The two companies already have a history of cooperation, including as JV partners for the operation of Cameroon's Kribi Port.

The case illustrates the novice status of Chinese infrastructure construction companies when it comes to investment and operation. First, CHEC's ability to initiate a complex infrastructure project remains untested. It essentially inherited the concession agreement of Lekki Port from Tolaram, which had done the heavy lifting of negotiating with the Nigerian government and designing the project in the early stage. This fact also gave the Lekki Port project a more convincing "commercial" profile since the Chinese government was not involved in negotiations with the Nigerian government (even though later on Beijing still labeled it as a project for Belt and Road cooperation with Nigeria). However, it remains a question if CHEC could have concluded a concession agreement with the Nigerian government had it been the initiator, and what the political dynamics would have been.

Second, CHEC's involvement in Lekki Port's operation critically hinges on CMA's role as the majority partner. On the one hand, this partnership seems mutually beneficial: CHEC can gain experience in port operation through cooperating with CMA, while CMA gains access to key infrastructure and consolidates its market position in Nigeria, without spending capital on the physical construction. On the other hand, controlling only 20 percent of the stake, CHEC may not have enough influence on key decisions regarding the port's operation, which casts doubt on its ability to reap financial rewards to compensate for its investment. In other words, CHEC could be putting itself in a vulnerable position by relying on CMA to deliver the financial return it needs.

This case thus highlights the steep learning curve for Chinese companies to climb up the value chain. As they attempt to climb, they may find it necessary to collaborate with other international players—especially those from advanced economies, who are already occupying higher positions in the value chain. The prominent share of Africa's international contracting market that Chinese companies hold do not automatically translate into the ability to upgrade. This helps explain why Beijing has been keen to bring in advanced economies as "third-party market cooperation" partners in its promotion of the Belt and Road Initiative since 2019.

POLICY RECOMMENDATIONS

This research suggests that China's infrastructure construction industry, financial institutions, and policymakers are cognizant of the problems with China's overseas infrastructure financing—including financial unsustainability for both host countries and China, and lack of accountability for Chinese companies. These actors have been seeking more rigorous ways for the continued internationalization of Chinese industry, but such an upgrade is unlikely to be straightforward.

(1) For developing countries seeking to leverage Chinese capital for their infrastructure development, the attempt by Chinese companies to move from contractors to investors can be a mixed blessing. Countries can reduce their sovereign borrowing from China and hold Chinese companies more accountable for their involvement in their countries' infrastructure development. But host countries also need to realize that Chinese companies are bound to make mistakes as novices in infrastructure investment and operation, so they need to be realistic about Chinese companies' capabilities and carefully evaluate their investment proposals; they especially should not expect financing from Chinese banks in such investment projects to be easy. On the other hand, as Chinese companies become more entrenched in their infrastructure sector as investor-constructor-operator, host countries should be mindful about localization and skill transfer requirements, lest it hinders the growth of indigenous industries.

(2) The Chinese actors' need to collaborate with other international players (especially those from advanced economies) also means that there are opportunities to manage the political tensions in infrastructure development by making such projects truly multi-lateral. Host countries should especially explore the possibility of engaging multiple players to co-develop projects, so that there can be checks and balances across different parties.

(3) For Chinese policymakers, it is also important to recognize that the transition to IICO is easier said than done, and IICO entails greater risks that China's current banking system and SOE regulations are not quite ready to cope with. Learning lessons from past EPC+F lending, Chinese policymakers should remain vigilant to potential moral hazards when providing policy support to companies, as information asymmetry between companies and the state about overseas markets can be exploited to the companies' benefit while causing loss in public resources and damage in the national reputation. ★

ENDNOTES

1. Boston University Global Development Policy Center. 2023. China's Overseas Development Finance Database. Retrieved from http://www.bu.edu/gdp/chinas-overseas-development-finance/.
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