# China-Kenya Cooperation on Sustainable Growth in the Post-Pandemic Era

## A Case Study on the Mombasa-Nairobi SGR

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### Introduction

China and Kenya have had a long history of beneficial relations. China-Kenya diplomatic relations were established in 1963 and signed bilateral trade agreements in 1978. In the 1980s, China built the Moi International Sports Center in Kenya, which cost 200 million RMB. China's aid and investment in Kenya has further increased in the past two decades. Kenya adopted the "Look East" foreign policy around 2006, making it possible for Chinese players to enter the Kenyan market. As China put forward the Belt and Road Initiative and expanded it into Africa, Kenya became an essential pivot for China in East Africa.

Nowadays, China is the largest trading partner of Kenya, the largest source country of contracted project companies in Kenya, and the country that provides most concessional loans to Kenya. As more and more infrastructure projects were undertaken in the framework of the BRI, speculation and criticism arose concerning China's construction projects in Kenya, especially towards those with strategic significance. The most frequently mentioned is Kenya's debt burden brought by the Chinese aids and loans. In 2018, China was Kenya's largest lender and 72% of Kenyan bilateral debts were owned by China. The massive amount of debt is not China's intention but is a result of the characteristics of Chinese infrastructure projects in Kenya. Compared with other sectors, such as manufacturing, infrastructure needs a longer term to make a profit. However, the debt generated by China's projects has become a major obstacle to the China-Kenya relationship, as well as China's reputation inside and outside Africa. Meanwhile, the outbreak of COVID-19 and its impact on China's profile in the international arena has made it more necessary for China to find a way out of this situation.

### Mombasa-Nairobi SGR and Chinese-Owed Debt in Kenya

In 2011, Kenya signed a memorandum of understanding with the China Road & Bridge Corporation (CRBC) to build a standard-gauge railway between Mombasa and Nairobi. The US $3.6 billion railway was the largest infrastructure project in Kenya since independence. Financing was finalized in May 2014, with the Exim Bank of China, extending a loan for 90 percent of the project cost and the remaining 10 percent coming from the Kenyan government. For the total US $3.2 billion loan, the Exim advanced the loan amount in two loans of equal amount. One of the loans was a foreign aid loan on a concessional basis, and the other was a below-market rate preferential export buyer's credit. Tracklaying was completed in December 2016. Passenger service was officially inaugurated on 31 May 2017. The Kenyan government rejected a planned international tender on the railway operation and contracted the mother company of CRBC to operate the line for its first five years, because of the loan condition by Exim Bank that the railway should be operated by an operator acceptable to the bank for the initial phase of operations.

The standard-gauge railway (SGR) operates both passenger and cargo services. In July 2021, the Mombasa–Nairobi SGR celebrated its 1,500 days since the operations. The modern train service has been at the forefront of Kenya's socio-economic transformation in the last four years. A total of 5,415,000 passengers have been ferried between Nairobi and Mombasa in the last 1,500 days since the SGR commenced operations, and the operator estimates 1.8 million commuters could use the service this year. While passengers embrace it for reducing travel time compared to buses, cargo owners shun it for reasons including higher fees and tariffs, additional time clearing goods, and a lack of last-mile delivery, when compared to trucks. Since the Mombasa-Nairobi SGR has been in operation in 2017, its operator Africa Star Railway Operation's expenditure has always exceeded revenue, and Kenyan taxpayer money has had to fill the gap to sustain the company's operations.[1]

In 2018, documents tabled by Kenyan Transport Ministry revealed that the Mombasa-Nairobi SGR averaged a monthly loss of Sh750.7 million in its first six-month operation, mainly due to low cargo business.[2] With no extra profits to repay the debt, the SGR became one of several avatars for Chinese-owed debt in Africa. In May 2020, three years since the railway officially operated, the railway netted Sh25.03 billion in revenue over the period against operational costs totaling Sh46.71 billion, posting a combined operating loss of Sh21.68 billion. The Kenya Railways Company (KRC) was faced with a default on an estimated Sh40 billion payout to China's Africa Star Railway Operation Company, which runs both passenger and cargo services on the SGR, due to the operating loss.[3] In December 2019, China was Kenya's largest bilateral lender, with loans of $6.37 billion generated by a range of different agreements.

## Impact of COVID-19 on the China–Kenya Debt Problem

The COVID-19 pandemic has hit Kenya's government revenue and limited its access to the commercial loan market. In 2020, there was a slight contraction of 0.1% in the Kenyan economy, but it has been picking

① Carlos Mureithi, "Kenya's expensive Chinese-built railway is racking up losses even as loans come due," *Quartz Africa*, October 9, 2020, https://qz.com/africa/1915399/kenyas-chinese-built-sgr-railway-racks-up-losses-as-loans-due/ (accessed December 16, 2021).

② Lee Mwiti, "SGR makes Sh10 billion loss in first year," *The Saturday Standard*, July 18, 2018, https://www.standardmedia.co.ke/business/business/article/2001288487/sgr-makes-sh10-billion-loss-in-first-year# (accessed December 16, 2021).

③ John Mutua, "SGR reveals Sh21bn loss as China firm debt rises," *Business Daily*, September 9, 2020, https://www.businessdailyafrica.com/bd/economy/sgr-reveals-sh21bn-loss-as-china-firm-debt-rises-2300880 (accessed December 16, 2021).

up since then. The International Monetary Fund (IMF) forecast an economic growth of 7.6% in 2021 and 5.7% in 2022, but said Kenya continued to face challenges on durable growth, as its past gains in poverty reduction had been reversed. This pressure forced Kenya to turn to the World Bank and the IMF for direct budgetary financing, which it had kept away from during the administration of former President Mwai Kibaki, who preferred project support. Now, the cash flow situation, which is marked by flat revenues and worsening debt service obligations, has forced the country to return to these loans with conditions attached to them. In May 2020, the IMF raised the country's risk of debt distress to "high" from "moderate" due to the impact of the pandemic, "which exacerbated existing vulnerabilities."[①] According to the IMF, Kenya's debt was 65.7% of its GDP by the end of June 2020.[②]

Kenya's economic difficulties during the pandemic further raised the tension between China and Kenya in terms of the operation of the Chinese-built SGR and related debts. The Kenyan officials have been recommending the government renegotiate the SGR operation agreement. In October 2020, the Kenyan Departmental Committee on transport, public works and housing tabled a report in parliament regarding the operation of the SGR. The Committee proposed that the government should set up an open, nondiscriminatory policy that allows private investors to provide rail transport services through private trains and locomotives, in order to increase competitiveness and promote a stopover economy along the railway line. The Committee also proposed that private sectors should be involved to solve the last-distance connectivity, and that they should be allowed to extend the railway line to their respective yards. For the operation of the railway, the Committee suggested that the government renegotiate the current operation agreement by reducing the operations costs by at least 50%, and the terms of the Chinese loan for the SGR "due to the prevailing economic distress occasioned by the effects of Covid 19."[③] Ethiopia, another recipient of Chinese infrastructure loans, has also renegotiated its Chinese railway loans due to its economic struggle during the pandemic.

Kenya's potential incapacity to repay the China-owned loans caused further suspicion that China would take the Mombasa Port as compensation. Mombasa Port is among the most strategic assets in Kenya, and it generated $480 million in revenues and $125 million in profits in 2019. Back in November 2018, there had been reports on how Kenya is at high risk of losing strategic assets over huge Chinese debt. This anxiety came from former cases that the Sri Lankan government transformed the 99-year lease period of the

① Jackson Okoth, "IMF Raises Kenya's Risk of Debt Distress to High from Moderate," *The Kenyan Wall Street*, May 16, 2020, https://kenyanwallstreet.com/imf-raises-kenyas-risk-of-debt-distress-to-high-from-moderate/ (accessed December 16, 2021).

② David Herbling, "Kenya Faces External-Debt Distress on Lower Export Receipts," *Bloomberg*, September 11, 2020, https://www.bloomberg.com/news/articles/2020-09-11/kenya-sees-external-debt-distress-risk-on-lower-export-receipts (accessed December 16, 2021).

③ Departmental Committee on Transport, Public Works and Housing, *Report on the Inquiry into the use of the Standard Gauge Railway*, Report to the National Assembly, September 22, 2020 (Nairobi: Departmental Committee on Transport, Public Works and Housing, 2020).

Hambantota Port to China because it failed to show commitment in the payment of billions of dollars in loans in December 2017, as well as the case of Zambia Kaunda International Airport in 2018. The loss of the SGR in its first year of operation intensified this anxiety.

The worries around claims that the Belt and Road Initiative (BRI) is nothing more than Chinese debt diplomacy to secure strategic assets reached a crescendo at the end of 2019. The central claim is that China engages in "debt for asset" swaps to ensure control of strategic assets along the BRI. The African Stand reported that Kenya might lose the lucrative Mombasa Port and the Inland Container Depot in Nairobi should Kenya fail to repay Chinese loans, and that thousands of port workers "would be forced to work under Chinese lenders."[①] These arguments are reasonable to some extent, since some sources reported that Kenya has used Mombasa Port assets as security for the SGR directly linking debt repayments to assets. The loan agreement specifically waived Kenya's sovereign immunity on these ports' assets. However, in 2021, the Kenyan National Treasury cabinet secretary Ukur Yatani said that Kenya did not offer the strategic national asset as collateral for the Chinese loan, and that the port had no adverse exposure to any lender or category of lenders through existing loan agreements with the government.[②] Though he maintained the government is servicing the SGR loans, the runaway public debt led to mounting concerns that Kenya might default on its loan obligations, a risk that could expose the port to seizure by China.

**Outlook for China–Kenya Sustainable Cooperation in Infrastructure**

The COVID-19 pandemic has created an unfavorable context for China-Kenya cooperation. The pandemic affected Kenyan economic growth and made it more vulnerable to public debt. More specifically, on the Mombasa-Nairobi SGR, the railway made even less profit during the pandemic because of decreasing passenger services and cargo demand. There is also obvious turbulence in the international arena, China has been faced with more hostility and rivals globally, which hurts China's reputation around the world. Therefore, China needs to be cautious to its next move in Kenya, for a breakthrough in China-Kenya relations and China's global reputation.

Further China-Kenya cooperation should be focused on Kenya's comprehensive and sustainable economic growth. Connectivity is essential but the goods, information, and people flow along the connectivity facilitates are equally important. Taking the Mombasa-Nairobi SGR as an example, it is now creating a loss because there is not enough cargo for railway transportation and insufficient manufacturing industry and supporting facilities along the way. The railway may solve Kenyan connectivity problem but

① "China to take over Kenya's main port over unpaid huge Chinese loan," *Hellenic Shipping News*, November 22, 2019, https://www.hellenicshippingnews.com/china-to-take-over-kenyas-main-port-over-unpaid-huge-chinese-loan/ (accessed December 16, 2021).
② Njiraini Muchira, "Kenya: China Cannot Seize Port of Mombasa if Debt Default Occurs," *The Maritime Executive*, March 16, 2021, https://www.maritime-executive.com/article/kenya-china-cannot-seize-port-of-mombasa-if-debt-default-occurs (accessed December 16, 2021).

did not solve its productivity challenge Moreover, the debts may further hinder Kenya's investments in productivity. Therefore, in the case of Mombasa-Nairobi SGR, China should help Kenya to boost the economy along the railway and combine connectivity with productivity to generate maintainable profits. Also, China may help to solve the last-distance connectivity problem with Kenyans, in order to make its investments and loans more effective.

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