



Department of Business and Management  
Master's Degree in Corporate Finance

Course of International Financial Economics

***“The Economic and Geopolitical Drivers of  
Investments in Emerging Markets”***

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Academic Year 2024/2025

## Acknowledgement

This thesis was written as part of my master's degree in Corporate Finance at Luiss Guido Carli University.

I would like to express my sincere gratitude to my Professor **Guido Traficante** for their guidance, insightful comments, and timely guidance and support throughout the preparation of this thesis. Their insights and suggestions greatly improved the quality of my work.

To my family, I owe endless thanks, without their sacrifices and encouragement, I could never reach this point. Thank you for always being by my side and for inspiring me to give my best.

To my dear friend Michela, thank you for making this foreign country feel like home and for sharing both laughter and challenges. I am grateful for your support.

To my lifelong friends, on whom I know I can always count.

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### **List of Abbreviations:**

- IMF = International Monetary Funds.
- DM = Developed Market
- EM = Emerging Market
- EMNEs = Emerging Economy Multinationals Enterprises
- CFIUS = Committee on Foreign Investment in the United States
- FDI = Foreign Direct Investment
- EMDE = Emerging Market and Developing Economy
- GDP = Gross Domestic Product
- US = United States
- EU = European Union

- EEA = European Economic Area
- NZIA = Net-Zero Industry Act
- RQ = Vulnerability Gradient
- FX = Foreign Exchange
- BIS = Bank for International Settlement
- PPP = Public-Private Partnership
- BOT = Built Operate Transfer
- SGR = Sustainable Growth Rate
- MSR = Marine Silk Road
- BRI = Belt and Road Initiative
- FOCAC = Forum On China Africa Cooperation
- OECD = Organization for Economic Cooperation
- CPI = Consumer Price Index
- BOT = Build Operate Transfer
- BOOT = Build Own Operate Transfer
- QE = Quantitative Easing
- QT = Quantitative Tightening
- AIIB = Asian Infrastructure Investment Bank

# **Introduction:**

The economic and geopolitical factors influencing investments in emerging markets can differ from one setting to another which is explored in this thesis. We may observe that nowadays an increase interest in the emerging markets which is often discussed and captures the intentions by many parties such as government, managers and stakeholders due to its large potential of development and unique risk profile that make this research paper quite relevant. One of the most rapidly developing sectors of the world economy during the last two decades, emerging markets are still remaining highly exposed to financial volatility, political instability and external shocks. These weaknesses have been manifested in recent crises where the inflows and outflows of investment have on a lasting effect on growth and development.

The available literature suggests that the capital flows are contingent on the quality of institutions, government and policy. As research present that certain emerging economies used the foreign investments to realize structural changes and transformation. However, others have restored to dependence on the resource exports or on the debt distress. Even though extensive literatures researched on the economic advantages of the FDI and the risks of unstable portfolio flows there are less literatures have specifically researched the dual economic and geopolitical role of investment strategies. It is with this gap that this thesis intends to combine both dimensions in a unified analysis.

The objective of the paper research is the development and formulation of a deeper understanding of the economic and geopolitical drivers that influence investment inflows into emerging markets. In the form of foreign direct investment, portfolio flows or the public private partnerships which plays a decisive role in the development paths of the host economies as well as reflecting the board strategic interest in the investing regions. Although emerging markets are typically financial and institutional constraints that are considered the key engines of global expansion and are becoming the core of economic power. The important research question of the study is the following:

## **How do Economic and Geopolitical drivers influence the direction and risks of Emerging Market Investment?**

The structure of the thesis is as follows: First section reviews the theoretical background and outlines the existing debates on globalization, institutional frameworks accompanied with

capital flows. The second section outlines the key process of investment in emerging markets, foreign direct investment portfolio flows and public-private partnerships and their economic and geopolitical consequences as reviewed. The third section is devoted to the case of China's Belt and Road Initiatives in Africa which analysing the strategic importance, financial impact and the associated risks. Section four is the conclusion of the research summarizes the major findings, policy implications and suggest directions for the future research.

# Chapter 1: Economic and Geopolitical Foundation of Investments:

## 1. Importance of Emerging Markets for Global Economic Growth:

Emerging markets are presented as an economic growth, it is the progression from limited financial and industrial capability to advanced, sophisticated, mature economic system and globally engaged markets. Despite the ongoing challenges involved in weak regulatory systems and political insecurities, these economies have an important role which is by time increasing in driving global growth.

As presented by IMF<sup>1</sup>, it forecasts a great acceleration of developing and emerging economies compared to advanced economies with a growth rate of 3.9 percent in 2023 and 4.2 percent in 2024 (Fund, 2023). Wu and Pan<sup>2</sup> highlights the catching up potential of a group of E30<sup>3</sup> emerging economies, whose potential is supported by favourable demographics, structural reforms and increasing participation in the international trade and financial markets. These sectors offer the investors with the chance for higher risk adjusted returns and initial strategic position in newly expanding consumer markets and multinational value chains (Pan, Economic Growth in Emerging Market Countries, 2021).

The E30 list of emerging market economies were chosen for their growth prospects and their solid development potential. These countries were chosen on the basis of rate growth, economic size, demographic and for their future development potential represent a prime sample of structural reform influence and globalization over the emerging and together the list of E30 economies shows about 62.5 percent of universal population and 34.2 percent of the world GDP in 2017 (Pan, Economic Growth in Emerging Market Countries, 2021).

Some of the markets presented have sought structural reforms like trade liberalisation, developing regulators and modernisation of the banking industries with an insight of strengthening macroeconomics stability and lowering the foreign investment barriers, the efforts are able to increase the access of the developing countries to the multinational finance

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<sup>1</sup> International Monetary Fund. 2023. World Economic Outlook: A Rocky Recover. Washington, DC. April.

<sup>2</sup> Shuyu Wu and Qingzhong Pan. 2021. Economic Growth in Emerging Market countries. Beijing.

<sup>3</sup> The E30 presents economies from Asia, Latin America, Africa and Easter Europe: China, India, Brazil, South Africa, Turkey...

and trade, since they are able to form strategic nodes in the global value chain (Stiglitz, 2003)<sup>4</sup>. Particularly, the Asian emerging markets has contributed with 88.3 percent themselves, with China, Indonesia, Turkey and Saudi Arabia creating the bulk of the group output in transparent evidence of regional concentration in the big story of growth (Pan, Economic Growth in Emerging Market Countries, 2021).

Natural resources has provided numerous emerging markets to open, especially in areas that contains gas, oil and mineral deposits, as an example for that we have Latin America and parts of Africa, where the natural resources present a vital and important export revenues and an increase fiscal strength, the assets generates an important export earnings and is able to improve financial reserves (Fund, 2023). The dependency on commodity cycles is as well a significant material, the IMF has predicted the cost of crude oil to fall by approximately 24 percent next year in 2023 to approximately 73 dollars per barrel on an average basis (Pan, Economic Growth in Emerging Market Countries, 2021) (Fund, 2023). From an investor perspective emerging markets provide portfolio diversification, open a gateway for greater potential returns, and offer the possibility to provide lower risk portfolio management, as the returns to the financial assets of these regions are generally not strongly correlated with the returns to the financial assets of the industrialised countries. Therefore, emerging markets are still continuing to attract attention and has been perceived as a good opportunity for investors and governments even with the existing of some risks (Fund, 2023).

When diversification and natural resources are positive and beneficial to returns, the performance on new markets also remains as a question of the convenience of services and goods along with capital moving across the border. By the year of 2025, the situation with policy driven tariffs has been reversed as well as trade policy, in the World Trade Organization forecasts that the volume of world merchandise trade will decrease by 0.2 percent in comparison with modest growth before tariff shock (Organization, 2025)<sup>5</sup>.

Nevertheless, the global trade in in goods and services is expected to slow down to 2.4 percent in 2023 and on average the emerging and developing economies growth is expected to moderate to 3.9 percent, where it can be an indicator of investments in frontier and how the avenues of globalization can be closing down to slow demand and emerging economies (Fund, 2023).

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<sup>4</sup> Joseph E. Stiglitz.2003 Globalization and growth in emerging markets and the new economy. New Yor, NY.

<sup>5</sup> World Trade Organization. 2025 Global Trade Outlook.

## 2. Key Economic Theories and Risk Considerations:

### 2.1. Economic Theories Supporting Investment in Emerging Markets:

Today's studies have shown that it has been a growing interest in the emerging markets, where it is considered a topic of discussion and an attraction of many parties such as governments, managers and stakeholders. Due to this study, we discover numerous important theories that allow to understand why.

Modern Portfolio Theory (MPT), forecast that the overall portfolio risk can be minimized by combining assets with imperfectly correlated returns to provide the same expected returns. The emerging market equities are usually tended to be not concurrent with the developed market equities, therefore this is the reason why a moderate EM exposure will tend to global mean variance trade off. As an example, we can suppose DM volatility equals to 15 percent and EM volatility equals to 25 percent, knowing that DM-EM correlation 0.3 and by adding 20 percent EM slice to DM only portfolio lowering the total volatility by 15 percent to 14 percent<sup>6</sup>, despite EM by itself is considered more volatile and by that this is the core diversification MPT captures (Harvey, 2003)<sup>7</sup>.

Simultaneously, there are special and unique risks associated with the emerging markets exposure which are relevant in building a portfolio; in July and August 2013 the cumulative outflows of EM bonds funds have experienced 33.6 billion in outflows where 19 percent of the previous 2009 and 2013 inflows, as a reminder that capital flows can present an effect on transmitting an international liquidity shock to the assets of emerging market rapidly (Omar Costa, 2014)<sup>8</sup>. On a larger scale, the capital account of the rapid liberalization is linked to procyclical assets inflows and to the higher macro financial volatility in emerging markets, where is able to increase the cost of capital and risk premia and taking into account when applying to diversification benefits to convert it into risk modified returns (Stiglitz, 2003).

Another theory that we can refer to is Internalization Theory, where it deals and address the reason why companies would rather carry out operations within the firm consistently through foreign direct investments and entirely owned subsidiaries instead of outsourcing via an external market. In situation when large markets to obtain the management expertise,

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<sup>6</sup> The MPT variance formula is presented as:  $\sigma_p^2 = w' \Sigma w$  with stated parameters.

<sup>7</sup> Geert Bekaert, Campbell R Harvey. 2003 Emerging markets finance.

<sup>8</sup> McKinsey&Company. 2014 Risk in emerging markets, The way forward for leading banks.

distribution, technology or even fund raising are either insufficient or they are costly to utilise or business execute buying domestically to assure the knowledge and minimize transaction and integration costs, and to achieve predictable quality; from recent research indicates that this reasoning is particularly relevant to emerging market multinationals on the basis of the landmark analysis by Buckley<sup>9</sup> (Buckley, 2017).

Generally, the EMNEs purchases some business in more advanced and developed economies where it combines packages of management knowledge, strategic resources technology and distribution. In certain Chinese takeovers acquisitions acquires did not dismiss the management of acquisitions and carrying the advantage of capability absorption in a rapid way, where in the United States of America for example, where the Committee on Foreign Investment known as (CFIUS) studies foreign acquisition which are based on national security consideration and may decides whether to reject them or impose conditions, it is a factor that generally encourage and push investors to greenfield investments or joint venturing project instead of full-fledged acquisitions and it shows that the restriction that the foreign countries adopt to limit takeovers can be eased (Buckley, 2017).

Home market financial imperfection is yet another emerging market particular process, a quote from Buckley that present an estimation that the policy of financial repression in China had the effect of suppling approximately 5 to 6 percent of Chinese GDP on business, restraining outbound buying, as an example we have applying internal capital market where external finance is either disorder or poor (Buckley, 2017).

## 2.2. Risk Considerations in Emerging Markets:

In comparison to studies that indicates a positive relation in emerging markets and the consideration of being a benefit for investors, stakeholders and government, there are also some other researches that present a substantial negative finding in emerging markets and need to take into consideration the risks.

First in order is the institutional and regulatory risks where the inward Foreign Direct Investment remains skewed toward advanced economies the wide majority of foreign inflows, political and legal risks, and the infrastructures thinness holds the capital at bay which is the

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<sup>9</sup> Peter J. Buckley. 2017 Internalisation theory and outward direct investment by emerging market multinationals UK.

key to the appeal of emerging markets in the futures; Groh and Wich<sup>10</sup> research shows that the political and legal qualities of a host country emerges as the highest predictor of the attractiveness and appealing of FDI with other factors along tested, with the standardized coefficient presented a 0.709 and 0.460 which is considered stronger than the business climate result or the general macroeconomic performance (Wich, 2012). The results of these risks can cause an increase or even double the price of the beginning or running a business and it can result in the rights and protection of future investors, uncertain tax, and unclear trade (Wich, 2012). Therefore the reduction in the long term confidence of foreign participants and limiting the possibility of future foreign investments where these risks are shown to be more integrated in regions that present frail laws or in state instructions that have shortfall of transparency and accountability (Wich, 2012).

Currency risk and external balance are a structural weakness in the EMs, the current account deficits are being financed by short term external financing which makes the subjection to the fluctuations of the exchange rates even greater. The case of the crisis that occurred in Thailand in the year of 1997 present an explanation where total of external debt being 108.7 billion US dollars with 47.7 billion US dollars are short term debt, which it exceeded the foreign exchange reserve, the current account witnessed a deficit approximately a 8 percent of GDP (Pan, Economic Growth in Emerging Market Countries, 2021) and this combination forced the degradation of the baht currency and the exposure of reserve vulnerabilities. Another example that can be mentioned here since it was recent is Egypt, where it had followed an inflation of 8.5 percent in 2022 escalating in 2023 to 21.6 percent and a currency shock (Fund, 2023). As a result, such conditions are able to reduce the reliability of financial planning and they are also able to place the investors and domestic economies in further disadvantages during periods of global stress.

Commodity price swings and terms of trade have the possibility to amplify macroeconomic cycles in EMs where the year 2022 energy markets corrected the price surge along with the IMF energy index decreased around 46.6 percent at the time of the decrease of oil prices by 15.7 percent which is between August of 2022 and February 2023, where the future data showed in 2023 averages of approximately 73 US dollar for each barrel, which is around 24

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<sup>10</sup> Alexander Peter Groh&Matthias Wich. 2012 Emerging economies' attraction of foreign direct investment

percent below the 2022 level securing external and fiscal positions for exporters while improving trade balances and inflations for importers (Fund, 2023).

Furthermore, in in region in Latin America and Asia, the risk of macroeconomic are considered substantial, where fiscal laxity, interest rate shocks and inflation can present a tightening to external finance and to displace domestic demand (Pan, 2021). Recently the five economies where the outputs are significantly concentrated are China, India, Turkey, Saudi Arabia and Indonesia that present 88.3 percent of the overall Asian emerging market output therefore the success in strengthening the region is capable of cancelling the underlying weaknesses (Pan, Economic Growth in Emerging Market Countries, 2021). Additionally, the possibility of being restricted is presented in the ability of some countries that rely more on external demand rather than on domestic absorption to soften the effect of global slowdowns especially in the condition of terms of trade flows (Pan, 2021).

IMF report shows that macroeconomic financial tightening sets the global risk free rate higher since it increases the funding costs, it will decrease the investors total risk tolerance, since the policy rates are being raised due to the pandemic by big central banks in the advanced economies and the sovereign spread of EMDEs is starting to open considerably in the half of the year of 2022 before reversing, the high for long debt path and the larger share of short maturity conditions that is keeping the rollover risk high since the maturities bunch into tighter window with the public debt that is still to elevate (Fund, 2023).

On the financial intermediation side, the stress manifests rapidly that can result in creating bad assets and increases the prices of finding when the growth stalls and the rate increases. The loan loss impairments of emerging market banks are reaching to triple at the end cycle in 2007 to 2012 to 12 billion US dollars to around 34 billion US dollars, where in some regions also in the Eastern Europe, the loan deposit ratio is reaching to approximately 130 percent which make them more dependent on the wholesale markets, decreasing the credit constraints when the liquidity is becoming tighter (Omar Costa, 2014).

The presence of four faults predominates in the emerging markets, which are institutions or the regulatory quality, external and currency balance, tighter global rates and terms of trade shocks, when the presence of a pressure they will increase the cost of borrowing, accompanied by stretch reserves and exchange rates and drain away the growth outputs. the consequence is the returns are more realistic in the subject of when institutional are being credible, debt profile is

being long and properly hedges and the external buffer is substantial (Pan, Economic Growth in Emerging Market Countries, 2021)

### **3. Geopolitical and Interests and Investments as a Tool for Influence:**

The influence of geopolitical nowadays extends beyond the compositions of cross border investment and geography but it is a motivating powers to allocate capital instrumentally favoring strategic sectors, regions of heightened importance and allied countries.

#### **3.1. Strategic Use of Investment by Major Powers:**

the major powers apply cross border investment to guarantee the establishment of standers, supply chains and geopolitical compliance. In accordance with the IMF, a slowdown in the world investment flows, generally referred as Slowbalization from the year of 2008 Global Financial Crisis, where the FDI decreased by half in the 2000s to approximately 3.3 percent of global GDP between 2018 and 2022 (Fund, 2023). This transition can be noticed in government strategy and corporate strategy since firms discuss reshoring and friend shoring and when the legislation such as US CHIPS and Science Act, the Inflation Reduction Act accompanied with EU Chips Act provide incentives in the shape of capital allocations forward to the partner or domestic country production in critical industries (Fund, 2023).

As the IMF gravity models present that the geopolitical alignment can become an economically significant choice of where investment flows and the relationships between distant and close geopolitical with a shift in the geopolitical distance of the 25<sup>th</sup> and 75<sup>th</sup> percentiles, these shifts are being already an indication by the high and low level effect of approximately 17 percent on bilateral FDI even when taking into consideration the standard determinants, as illustrated in the example of United States, precisely the geography of outward greenfield FDI in the year of 2020 has shown to be reoriented at least towards more aligned locations in the line with this trends (Fund, 2023).

In the example of managerial expertise and technology, they are not contracts reliably on open markets, emerging market multinationals in effect internalise the same by high control merge and acquisitions where it is more explicit through acquisitions that does not break up the target and preserve the management to absorb tacit knowledge (Buckley, 2017). The takeovers of the

Chinese in the United States are being limited by the review of the committee on Foreign Investment CFIUS in the US, where it generally shifts the entry into greenfield or joint venture projects, the influence of home finance are presented lower outward FDI costs through domestic capital market aggregates with soft budget constraints, easy credit and group internal banks with the estimation that was studied by Buckley that present financial repression transferred to business a proportion in line of 5 to 6 percent of Chinese GDP, considering that the source of finance was effectively subsidizing outward acquisitions (Buckley, 2017) and for the host countries especially these reallocation strategies are consequential for the ones with fragile economic structures.

The international monetary fund vulnerability index present that most of the emerging markets and developing economies especially the ones that have over reliance on FDI sourced by geopolitical distant investors reveals a great risk of relocation, a comparative increase in regulatory quality where it graphically decrease the threats and the dynamic stochastic general equilibrium stimulation and reveal that the long term impacts of persisting cross bloc investments barriers on the world GDP fall to a maximum of 2 percent with thinner larger reduction of EMDE (Fund, 2023).

### 3.2. Impact on Recipient Emerging Markets:

Cross border investment can be used by EMDEs to achieve a higher growth by spillover effects and capital deepening, where it can also include supplier linkages, competition enhancement and technology transfer, even though the effects will be different according to the absorption capacity that they have, we can mention market competition, quality of policies and human capital (Fund, 2023).

To enhance and increase the FDI, countries with better legal political systems and infrastructure, captivates and hold on a higher level of FDI where it is statistically significant variables in forecasting the level of FDI, so reforms in areas that are the key to realising the inflows to have lasting productivity enhancement (Wich, 2012). In the opposite of portfolio operations, the FDI is more likely to bring Know-how <sup>11</sup>and less subject to fluctuations, however, this is not mainly comes with weak foundations in the growth in the financial systems

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<sup>11</sup> Know-How signify the implementation focused capabilities, the transfer of intangible assets such as technological capabilities, management expertise and apply them.

or even when the capital accounts are being open definitively (Stiglitz, 2003) (Ahlstrom, 2014)<sup>12</sup>.

Currently, the bar of sustainable profit is becoming higher where the IMF vulnerability index illustrates that host countries with geopolitically distant partners present more relocation risk, and greater quality regulatory factors reduces the exposure significantly (Fund, 2023). In the model stimulations that reveals trade and investment barriers between bloc lower the world GDP by approximately 2 percent with EMDEs realizing more, at the same time tightening financial conditions from the year 2022 have shown an increase in borrowing costs and rollover risk and lowering fiscal space as investment needs increase (Fund, 2023).

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<sup>12</sup> Michael N. Young & Terence Tsai & Xinran Wang & Shubo Liu & David Ahlstrom. 2014 Strategy in emerging economies and the theory of the firm. New York

# **Chapter 2: Mechanisms of Investments and Strategies**

The mechanisms of investment and how it is involved in the development and growth of emerging markets and how the geopolitical factor structure development results and define the primary classifications of investment strategies. FDI, which is presupposes a long-term ownership and dominance of companies. Portfolio investments imply a short-term positions in financial assets and the public private partnership are presented as an encouraging framework to stabilize long term infrastructure finance. It features the multiple nature of investment along with taking the short-and long-term impact of investment flows on host economies and stimulating economic growth and potential instrument of political influence. It presents how they can have short run spurts in growth and financial instability or long run structural adjustment, it can chronic susceptibility depending on domestic markets and policy frameworks.

## **1. Foreign Direct Investment and Portfolio Investments:**

### **1.1 Foreign Direct Investment:**

Foreign direct investment is referred to an institution or a person of a particular country or a nation investing in business. Where it is being undergone in a different nation and where a long-term relationship and degree of control of management is being viewed.

FDI plays an important role in not only in development of emerging markets and supporting growth but also joins in influencing the global economy. It is generally marked by transfer of technology, know-how and capital to the host countries. It has been considered as a significant one in driving force where FDI has the ability and potential to create jobs along with increasing productivity using technology spillovers and assimilate host economies into the global value chains (Fund, 2023). The association of global foreign direct investment with the development is especially seen in the spreading of technology and productivity achievement in EM however the long-term tendency is not a straight rise when in the mid of 2000 for instance flows were shown to be climbing to an all high of in 2007 around 1.833 trillion US dollar along building

and transition economies receiving just about 500 billion US dollars which is approximately one third of the total (Development U. N., World Investment Report, 2008)<sup>13</sup>.

The FDI stock have over again went from the high-end economies which is about three quarters of inward stock of FDI globally during that time (Wich, 2012). Along with the EMs engaging in enhancing share of new flows with around 54 percent of the global inflows in 2013 where a better investment climates and liberalization generate a better opportunity and chances (World Investment Report, 2014)<sup>14</sup>. Yet, the global financial crisis has shown results of FDI structural measures decreasing with relation to world GDP where it is falling to approximately to 3.3 percent of the world GDP in the years of the 2000 and a 1.3 percent in 2018 and 2022 (Fund, 2023).

FDI flows are increasing and being distributed by geoeconomic fragmentation resulted by the rising international disputes especially between China, US and the invasion of Ukraine being caused by Russia with a global FDI decline reaching a 1.3 percent of GDP (Fund, 2023). A negative spillover to the international economy where stakeholders are considering a method where they can be able to make the transformation of their investments to other regions with more similar political orientations and to make sure that the supply tunes are not being affected by geopolitical conflicts (Fund, 2023).

The increase of multinational corporations embracing friend shoring practices in where they are moving FDI to geopolitically favourable nations especially FDI between the aligned countries enhanced by 15 percent and to smaller ones by around 20 percent between the second quarter of the year 2020 and the fourth quarter of the year 2022 (Fund, 2023).

United States policy present supply chain realignment as a diversification to trust partners. Instead of a wholesale break with China, in April 20 of 2023, speech at Johns Hopkins SAIS Treasury Secretary Janet Yellen announced that we do not aim to decouple our economy from that of China, complete decoupling of our economies would be catastrophic and the need to focus on specific actions to ensure national security and diversity of key supply chains should be highlighted (Secretary Statements & Remarks, 2023)<sup>15</sup>. Also, in 2024 she addressed and restated this position representing and emphasizing that the goal of healthy and secure

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<sup>13</sup> United Nations Conference on Trade and Development. 2008 World Investment Report New York & Geneva

<sup>14</sup> United Nations Conference on Trade and Development. 2014 World Investment Report New York & Geneva

<sup>15</sup> Remarks by Secretary of the Treasury Janet L. Yellen on the U.S. - China Economic Relationship at Johns Hopkins School of Advanced International Studies

economic relationship as well as diversification of supply chains (Secretary Statement & Remarks, 2024)<sup>16</sup>.

The European Union has been combining the derisking accompanied with industrial policies to restake a clean technological manufacturing with the Net Zero Industry Act (NZIA). The Single Market, established a 2030 target on the EU manufacturing volumes to move straight or to stabilize 40 percent of the annual deployment requirements in strategic net zero technologies, an explicit Create it in Europe push to remove strategic dependency and manage investments (Net-Zero Industry Act, 2025)<sup>17</sup>. France in other hand has also enhanced filtering of foreign investments, the 10% of voting rights test for non-EU/EEA acquisitions of listed companies that operate sensitive activities, effective in first of January 2024 under the Decree number 2023-1293<sup>18</sup> (Francaise, 2023). Permanent and contributes to the aim of protecting and anchoring strategic value chains to France.

### 1.1.1. Vulnerability Index:

Vulnerability index is introduced to identify which countries are most exposed to the negative effects of geo-economic fragmentation. The index is a combination of three elements. The geopolitical distance along theologies where a higher degree of misalignment between host and source countries results in greater friend shore vulnerability, market power where the risks of migration are lower for countries that are high exporters in a given sector. As investors have fewer options, and dependence on FDI of key strategic industries such as semiconductor, R&D, and advanced manufacturing (Fund, 2023).

The analysis from IMF report shows that even specific geopolitical distance has a substantial negative impact on investment flows. A shift in the distance of a pair between Canada and Japan and a high-distance pair between Canada and Jordan leads to a decrease in bilateral FDI by 17 percentage (Fund, 2023). Moreover, Countries such as Cambodia, the Dominican Republic, Jordan, and Tunisia are ranking among the most exposed, since their high reliance on foreign capital and weaker institutional frameworks (Fund, 2023).

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<sup>16</sup> Remarks by Secretary of the Treasury Janet L. Yellen at a Press Conference in Beijing, the People's Republic of China

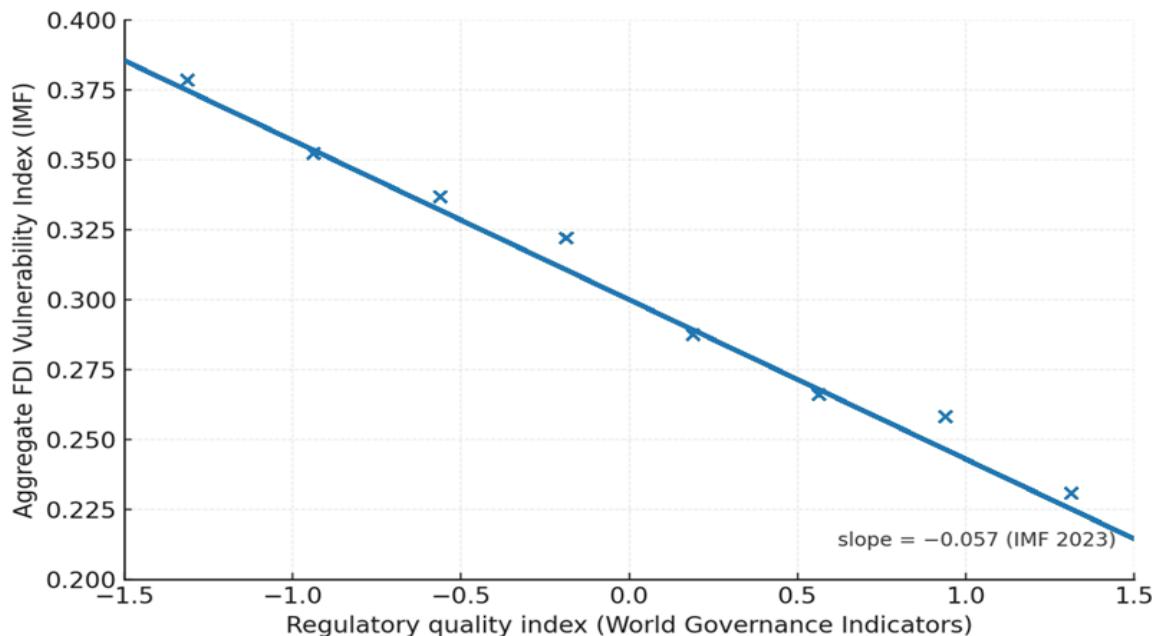
<sup>17</sup> European Commission. 2025 Net-Zero Industry Act

<sup>18</sup> Republique Francaise Decree No. 2023-1293 of December 28, 2023, relating to foreign investments in France.

Conversely, those countries whose position in the export market is stronger. Such as the United States, China and Germany are less vulnerable in this regard, as their influential positions reduce the tendency to migrate the investors. The risks of not being included in investment flow are higher in countries with low regulatory quality, for instance, the change as, the IMF cross-section as one goes through the weaker to a stronger regulatory environment decreases the fitted vulnerability index by about a tenth of an index point (Fund, 2023).

In order to test the hypothesis that domestic institutions can reduce relocation risk, Figure 1 plots the IMF cross-country regression between the aggregate FDI Vulnerability Index and the World Bank Regulatory Quality indicator. The estimated IMF line uses 128 countries 2010 and 2019 averages to produce the estimate and regulate by country size log real GDP, trade openness, and FDI inflows. Combined with a lower vulnerability of the IMF binned-scatter, higher regulatory quality is correlated with lower vulnerability.

**Figure 1 : Vulnerability vs. Regulatory Quality**



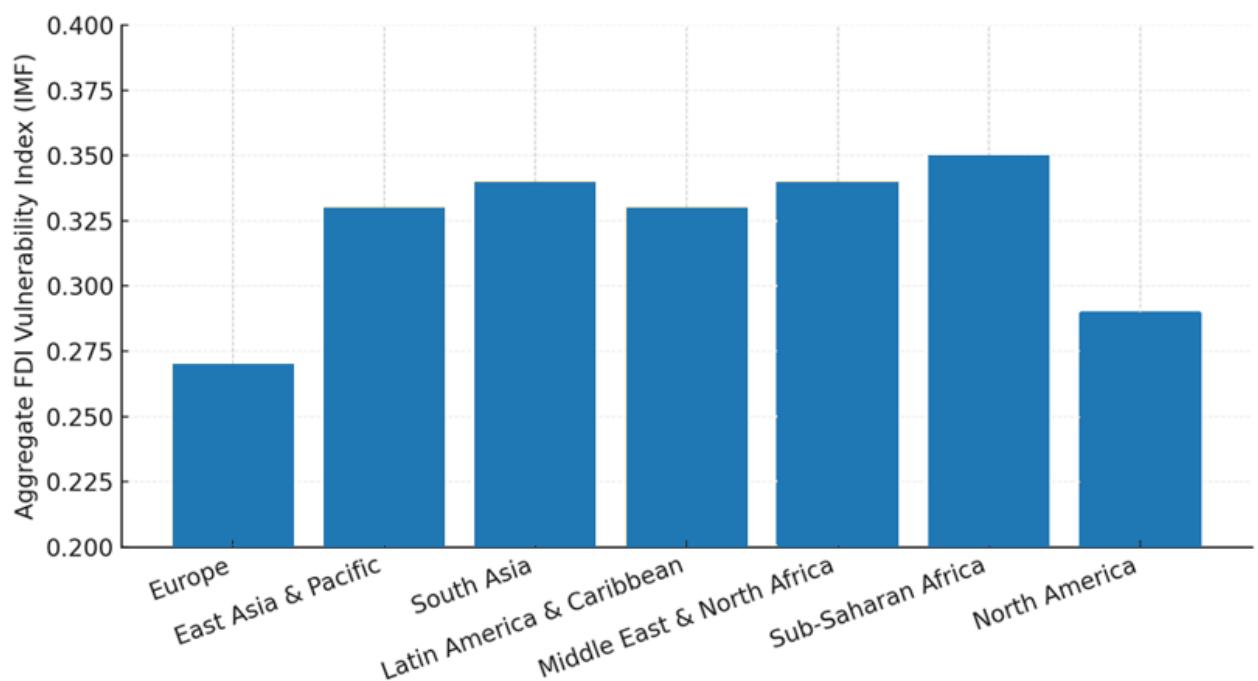
Source: Atlantic Council; Bailey, Strezhnev, and Voeten (2017); fDiMarkets; NL Analytics; Trade Data Monitor; World Bank, World Governance Indicators; and IMF staff calculations (Fund, 2023).

The graph shows a negative slope implies an explicit institutional dividend, with improvements in regulatory quality, the probability that firm claim existing FDI declines when measured. A two unit change negative 1 to positive 1 translates to about 0.11 less index points of vulnerability, not percentage points. This scale is economically significant and justifies a focus

on regulatory reform where predictable rules, predictable licensing and enforced contracts to anchor FDI and the productivity spillovers associated with it.

The vulnerability index is summarized regionally as in figure 2. In line with what the IMF panel believes Europe is lower in terms of aggregate vulnerability but most others are concentrated at higher levels.

**Figure 2: Average Vulnerability by Region**



Source: Atlantic Council; Bailey, Strezhnev, and Voeten (2017); fDi Markets; NL Analytics; Trade Data Monitor; and IMF staff calculations (Fund, 2023).

The regional pattern Europe is low. The majority of other regions crowd higher is due to the mechanics of the index, as well as structural fundamentals. Stronger regulatory quality, enforcement of contracts, and predictable licensing in Europe drive vulnerability down first consistent with the negative RQ. Second, geopolitical proximity where a great part of European FDI is sourced by likeminded, neighbouring sources and reducing the distance weighted exposure that raises scores in other areas. Third, market strength where the leading 10 export markets of Europe in autos, machinery, chemicals, and pharma trigger the dampener of the index, increasing the cost of relocation and hence reducing the chances of relocating. In most EMDEs, strategic investments like electronic assembly take place without an intensive export

base or solid institutions. The market power does not trigger much of the dampener and the index scores remain higher (Fund, 2023).

### 1.1.2. Implication of Emerging Markets:

Geoeconomic fragmentation poses threats to the scale of FDI, but it threatens its development benefits, Recall that FDI accounts for about 12 percent of the world stock of capital, so even small changes can be significant for growth (Fund, 2023). One of the clear advantages of FDI is the fact that its positive spillover is attained where it can be maintained through the availability of technology, innovation and productivity. Nevertheless, the study shows that spillovers have been weakened over time, the productivity boost by foreign investors is today largely restricted to the more developed economies within most emerging markets it is averagely weak or non-existent (Fund, 2023). This issue is particularly visible in the countries that are not members of major geopolitical blocs or the desired interconnection to controversial networks of investment, like Cambodia or Dominican Republic, where an insufficiency of the institution and external capital reliance intensify vulnerability (Fund, 2023).

Fragmentation has left a clear mark on current investment patterns between the second quarter of 2020 and the fourth quarter of 2022 where global FDI flows were roughly around 20 percent lower than pre pandemic averages, with the steepest declines observed in Asia most notably in China compared with more resilient inflows to advanced economies (Fund, 2023)<sup>19</sup>. This combination for emerging markets represents a weakening spillovers signals and a decrease in inflows that doubly penalized and get potentially less investment but also the investment that arrives is increasingly less transformative.

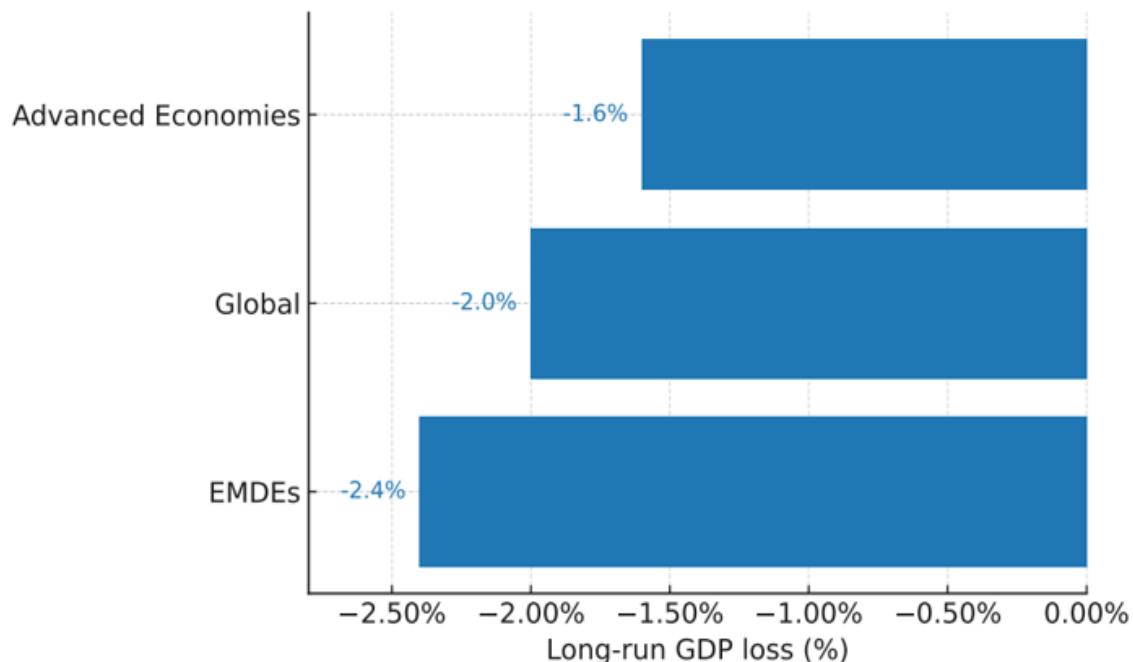
Fragmentation compromises the quality and quantity of FDI were reducing its capacity to effectively contribute to longer term development in these economies. Figure 3 measures the macro cost which in the extreme fragmentation case, the long-run world output decrease and the EMDEs experience greater losses than the advanced economies a quantity effect of a decline FDI. Figure 4 concentrates with quality where the FDI includes productivity spillovers assembled primarily manufacturing of advanced economies instead they are damped or even negative along supply chain connections in emerging market and developing economies. The

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<sup>19</sup> Figure shows deviation of regional foreign direct investment change from aggregate change 19.5 percent decline. Changes are computed using the number of greenfield foreign direct investments.

addition of the figures portrays a two-way punishment of EMDEs which is reducing foreign direct investments or lowering returns on the remaining FDI.

**Figure 3: Long- Run GDP Loss under Severe FDI Fragmentation**



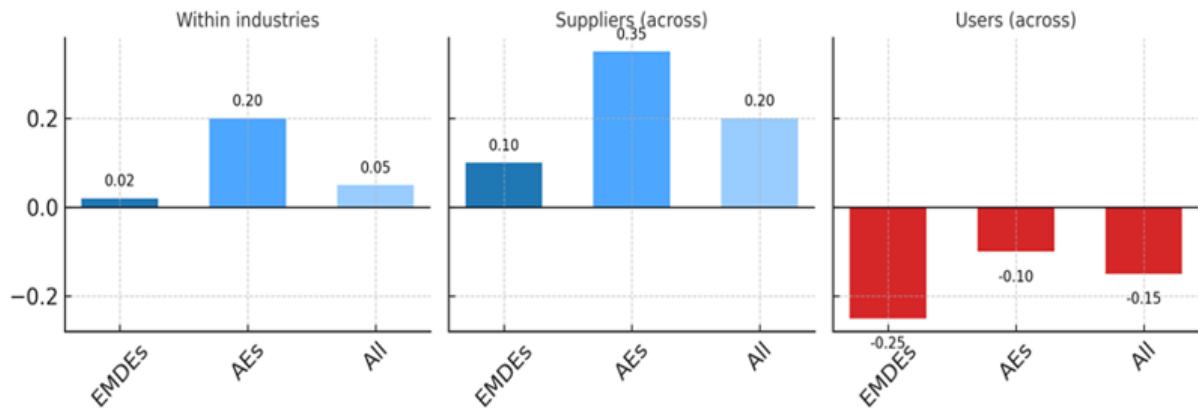
Source: Export-Import Bank of Korea; and IMF staff calculation (Fund, 2023)<sup>20</sup>

The 2 percent loss is a long run equilibrium outcome when capital stocks and supply chains have all become accustomed to the enduring cross bloc restrictions on FDI. The world economy will come to rest at a lower output level compared at the integer point. The losses fall unevenly. EMDEs goes through slower capital deepening, weakened technology diffusion and increased costs at duplicating production at subscale when the vertical FDI is diverted or deterred. Simultaneously, absorptive capacity FDI spillovers are smaller and occasionally negative across user industries. Therefore, the investment arriving is less transformative, the advanced economies cover the shock by having more robust institutions with greater domestic invention and market strength that renders shareholders less inclined or capable of moving them.

<sup>20</sup> Figure reports the standardized coefficients obtained from cross country growth regression estimated separately for countries with horizontal foreign direct investment and those with vertical. Solid bars indicate statistical significance at 1 percent level.

Fragmentation does not merely lower the global output but it increases the existing gaps which means that EMDEs will possess lower FDI and lower productivity returns on it.

**Figure 4: FDI Productivity Spillovers within Industries vs. Across Industries**



Source: Eora Global Supply Chain Database; fDi Markets; World Bank Enterprise Survey; and IMF staff calculations<sup>21</sup> (Fund, 2023).

To summarize the bars are the firm level of productivity spillovers which are associated with foreign presence and input output linkages. Spillovers are strongly positive within the industries in the AEs however they are close to zero in EMDEs which it indicates that the capacity absorptive is weaker among the domestic firms. Beyond the industries the supplier channel is positive in both groups foreign affiliates source more locally and domestic suppliers learn by assembling higher standers, yet the effect is considerably larger in AEs. On the other hand, the user channel is negative in the EMDEs which is consistent with the limited technology diffusion to the local buyers and other crowding out by the foreign intermediate producers.

<sup>21</sup> Figure reports the standardized coefficients obtained from firm-level regression of labour productivity growth as a function of foreign direct investment within and across industries. Solid bars indicate statistical significance at 1 percent level.

All things considered the figure present why the fragmentation that disrupts vertical, the supply chain FDI would affect EMDEs disproportionately. They are relying more on spillovers through suppliers linkages and capturing less within industry upgrading than the AEs.

### 1.1.3 Policy Recommendations:

Several numbers of strategies to check the risks and dangers of FDI fragmentation and maintaining its development functions. Improving the quality of institutional and regulatory frameworks since the higher regarded regulatory environment a country possesses and the weaker its score on the Vulnerability Index is and the more resistance shocks cause this country (Fund, 2023). The inflows of FDI sources as a trading partners need to be diversified to keep down the exposure to discontinuities associated with an assemblage of geopolitical blocs.

Instead of contracting relationships to existing allies were reducing diversification and enhancing concentration risk in common shocks where the policymakers can lower concentration risk by diversifying and spreading their networks of partners or standardizing extend the access with utilizing risk sharing instruments and focusing on a broader investor base (Fund, 2023). For instance, greenfield FDI has decreasing by approximately 24 percent from the second quarter of 2020 through the fourth quarter of 2022 when in comparison with the period of the first quarter of 2015 through the first quarter of 2020 the projects that did go forward were increasingly aiming on geopolitically closer destinations and FDI between closely connected bilateral partners enhanced after 2018 (Fund, 2023).

The infrastructure enhancement and digitalization are essential to secure long-term investment. The businesses are increasingly desiring more reliable power and fast transport infrastructure such as ports, roads, rail with low risk of delays and resilient digital infrastructure or broadband connectivity to access to data centres and e-commerce easing tools like single window customs, e-invoicing, e-payments, and e-signatures. These characteristics reduce logistics that lead times and coordination costs with making it easier to anchor vertical FDI which is the form most linked to stronger growth spillovers and to keep projects in times of geopolitical tension (Fund, 2023).

In IMF fragmentation world where combinations of policies and screenings could force cost-conscious firms to accommodate networks. Countries are able to secure the reliability of

logistics and the digital operating rails are more likely to scoop up shifted projects and balance flows (Fund, 2023).

The stability of macroeconomic is crucial where the prudent fiscal management and sound monetary policies are contributing toward maintaining investors confidence in the looming international environment. The IMF (Fund, 2023) reports that trustworthy medium term fiscal fundamentals which includes a clear debt anchor and valid primary balance trajectories announce that a 1 to 2 percent of GDP improvement during 2 to 3 years and built up buffers can be utilized during periods of uncertainty and predictable as well as communicated monetary policy.

When the policy misalignment takes place, the funding conditions decline hastily and the EMDE sovereign spreads open up significantly in mid of 2022 before slowing to early 2023 while also according to the (Fund, 2023) downside stress case corporate spreads widen by about two hundred fifty basis points. The US bank lending drops by about 4 percent, the dollar appreciates by about 10 percent and EM sovereign premiums widen. Comparable medium-term development of debt sustainability is as well corroborated in the panel of sixty-two EMDEs. Where one standard deviation higher structural reform contributes to around 0.6 percent higher real GDP over five-year periods and to a 1.5 percentage points declining in the public debt ratio with controlling purely for phenotypic reduction effects (Fund, 2023). IMF directors highlight the need for direct fiscal monetary cooperation in order to reimpose inflation to target and preventing loosening the expectations also the rebuilding buffers with credible medium term fiscal plans rather than by slashing debt through high inflation (Fund, 2023).

In practice, making public a rolling three or to five year fiscal plan with a quantified debt anchor and clear escape clauses, regular quarterly forecasts and central bank showing the way that maintains sufficiently restrictive policy until tangible disinflation is achieved and reducing of the probability of stop go cycles that discourage long horizon FDI (Fund, 2023).

Taken all together, these policies would lower the likelihood and the consequences of fragmentation while making emerging markets dollar denominated and cross-bloc investment. By increasing regulatory quality, expanding partner networks and improving hard and digital infrastructure which countries are able to secure FDI amounts and regain growth-improving spillovers particularly from vertical and supplies linkage projects. The goal is commonsensical in practice which reduce concentration, speed up logistics and provide believable macro

frameworks on which to anchor confidence a leaner FDI source HHI<sup>22</sup> ratio, paperless customs 24 hour port length of stays and a rolling three to five-year fiscal blueprint with an anchored debt wall (Fund, 2023). The payoff is optionality economies remain appealing across blocs or can lock in the sidelined projects and continue to raise productivity gains without polluting the global herd of investment realignment

## 2.1 Portfolio Investment:

### 1.1.2 Recent Trends:

Portfolio investment comprises cross-border ownership of equity and debt securities without the investor gaining control of the firm as opposed to FDI. The portfolio investment presents the positions and transactions of not falling into direct investment and reserves, and control of securities is set down as a 10 percent of voting power standard and below the voting power is portfolio investment and at or above it is direct investment (Statistics, 2009)<sup>23</sup>.

Emerging market portfolio flows since the pandemic have been driven by three external conditions, first the global interest rate expectations and term premia uplift in long-end yields raise discount rates and squeeze EM risk adjusted returns, then the level and trend of the US dollar where the dollar strength tightens EM financial conditions and weakening the local currency performance, and global risk appetite, which is proxied by market volatility and credit spreads (Fund, 2023). The data is consistent with this trend as the COVID 19 sudden stop conducting about a record of outflows of 83.3 billion US dollars in EM securities in March of 2020 flows recovered in 2021 but this time around the longest streak of monthly outflow record in history was posted as the advanced economy yields were rising, the dollar was strengthening and recessionary fears were mounting (Fund, 2023) (Hilgenstock, 2020)<sup>24</sup>.

The conditions in the year 2023 and 2024 has been improved for EM since rate expectations stabilized, the dollar moved down off its highs and volatility and spreads narrowed with an increase of 2.4 percent of world trade volumes reaching 3.5 percent and at the same time the enhancement of growth in EMDE was forecasted at 3.9 percent (Fund, 2023). Even though the

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<sup>22</sup> HHI = Herfindahl Hirschman Index. A measure of the market concentration, The sum of squared market shares of the global corporations.

<sup>23</sup> International Monetary Funds. 2009 Balance of Payment and International Investment Position Manual, sixth edition. Washington DC

<sup>24</sup> Jonathan Fortun & Benjamin Hilgenstoc. 2020 IIF Capital Flows Tracker April 2020 the COVID-19 Cliff. Institute of International Finance

IMF established that outflow risks had only slightly subsided. Put together, the evidence indicates that EM portfolio flows are procyclical and condition dependent but the FDI rebates slower.

In the early of 2025 The channel appeared with a clear procyclicality when the long-term advanced economy yields were supported and the US dollar strengthened. Increased risk-free rates enhanced the discount rates on EM assets and reduce the yield pick up on local currency bonds. An appreciating in the US dollar increases the cost of FX-hedging and aggravates currency mismatch pressures on the EM balance sheets and higher volatility and wider spreads reduces the risk budgets of benchmarked investors (Fund, 2023) (Hilgenstock, 2020). A result presented by the derisking The BIS “Markets caught in crosscurrents” as fundamentally a standstill in the portfolio flows as of 3 December 2024 and 28 February 2025, with the long-term yield increasing amid (Settlements, 2025)<sup>25</sup>.

In July 2025 the momentum once again reversed when emerging markets detected a 55.5 billion US dollars of weekly net portfolio inflows the second largest monthly flows in four years and investors placed around 30.8 billion US dollars into Chinese debt and 10 billion US dollars into non China EM equities (Campos, 2025)<sup>26</sup>. These forces align with BIS evidence that the US dollar is the first order since EM local currency bond and equity inflows which are commonly stronger than policy rate differentials and that weaker USD, low volatility and stable falling term premia are inflow favouring and the reverse combination is inflow demolishing.

Portfolio investment is the most cycle sensitive type of foreign financing to EMDEs. In general, relative to FDI it is more procyclical and exposed to sudden turnarounds as the global environment shifts (Stiglitz, 2003). Global push factors are a major stimulus to the mechanism. At very low interest rates in advanced economies investors seek yield and invest in higher exposures to EM portfolios. As financial conditions in the world tighten such exposures can be considered as unwound in a rush. One of the most clear ones was on June 2013 signal of taper by the US Federal Reserve which effected a reversal in capital flows into emerging markets and exemplifying how sensitive EM portfolio flows are to changes in monetary policy in major economies (Omar Costa, 2014). Accordingly, times of enhancement of global volatility and

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<sup>25</sup> Bank for International Settlements. 2024, Sep The US dollar and capital flows to EMEs. BIS Quarterly Review.

<sup>26</sup> Rodrigo Campos. 2025 EM portfolios see second biggest monthly inflow in four years, IIF data shows. Reuters.

policy rate repricing have been associated to broader EM sovereign spreads and difficult financing conditions settings where portfolio allocations are normally narrowed (Fund, 2023).

To compare, FDI is not as much as cyclical as portfolio capital and it tends to be more consistent throughout the cycle when even in the event of unexpected outflows of portfolios or sharp exchange rate decreasing and pressure on asset prices can be generated and increasing macro financial stress in the receiving economy (Stiglitz, 2003).

### 1.2.2 Volatility Drivers: Portfolio Flows vs FDI:

In comparison to FDI where the stable presence with an orientation towards control is developed, the portfolio and banking position are rather liquid and can be repositioned promptly. In the event the rest of the world pursues a change in financial conditions or geopolitics. The IMF runs a politically discounted series of the non FDI exposures by linking IMF CPIS data<sup>27</sup> with the IMF Locational Banking Statistics<sup>28</sup> to generate aggregated bilateral foreign asset and liabilities for 38 economies during the years of 2001 and 2021 (Fund, 2023).

furthermore, these exposures have approximately doubled in 20 years with a greater concentration in the asset side of advanced economies and the liability side of emerging markets and have now diversified as a proportion of GDP to nearly 42 percent or around 24 percent all non FDI cross-border assets and liabilities where a more than sufficient reason to consider the EMs especially vulnerable to sharp fluctuation (Fund, 2023).

An expansion in geopolitical tensions has the potential to catalyse a big redistribution in the world capital stock as well as most likely the sudden stop of cross-border flows, especially in EMDEs, through portfolio and banking modes but not FDI, which tends to adjust more gradually (Fund, 2023). Portfolio and bank exposures compared with FDI are the major channel of geoeconomic and financial shocks to generate rapid capital flow reversals in emerging markets.

Altogether, FDI and portfolio investments are quite different in nature. FDI is relatively stable and interested in long-term growth opportunities and can directly support productive capacity but it is not immune to geopolitical rearranging and demands healthy domestic conditions to deliver payoffs (Fund, 2023). The Portfolio flows are more opportunistic and capital sensitive

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<sup>27</sup> IMF CPIS data: cross-border portfolio holdings of equity and debt securities.

<sup>28</sup> IMF Locational Banking Statistics: cross-border bank claims and liabilities

to global sentiment, and they supply liquidity and capital in good times yet with dangers of abrupt reversal. An effective investment portfolio of a developing nation frequently entails a moderate combination when attracting stable FDI to construct the economic basis and developing domestic capital markets in such a way that when portfolio flows occur, they can be absorbed without destabilization (Fund, 2023). The analysis will consider how emerging markets can use public private partnerships to mobilize investment and what strategies solidify the stability of capital flows.

## 2. Public- Private Partnership and Capital Flow Dynamics:

### 2.1 Public- Private Partnership:

The external financing of EMs is driven by the world financial circumstances, transforming to public private partnerships since it is considered the tool that governments use to change macro geopolitical drivers into tangible projects that define how they are financed under what conditions and risks. When world interest rates increase and the US dollar robustness and hard currency debt becomes more costly and the traffic risk is repriced. To enable the project to remain bankable the concession transfers some demand risk to the public side through a tailored minimum revenue guarantee the special purpose vehicle seeks to hedge the FX exposures in proportion to debt service and toll caps are pegged to CPI to enable the standards of maintenance and service quality to be maintained (Bank, 2017)<sup>29</sup>.

The design of PPP arrangements sponsors mix and lenders, governing law, currency, payment mechanism, and incorporate the macro context into the risk allocation of the contract and the cost of capital to the state. PPPs is considered as the tool with the help of which governments translate those macro geopolitical drivers into real projects and decide who gets to finance them and what terms and with what risk (Bank, 2017).

A private partnership is a long-term output-based contract where a government engages a privately owned consortium to direct, create, finance, regulate and maintain a state asset or service. Typical forms of delivery are DBFOM/DBFO and concession methods like BOT/BOOT all define monitoring and reporting or penalty regimes, step in and termination

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<sup>29</sup> World Bank. 2017, 2024 Public-Private Partnership Reference Guide version. Washington DC.

rights and explicit handback conditions at the end of the 10-to-30-year term (Bank, Public Private Partnership Reference Guide, 2017).

Generally, the governments utilize PPPs to mobilize privately bargained capital and expertise in highways, energy, water and social infrastructure such as hospitals, schools to search of life cycle value and service level assurances where it can provide superior whole of life value and enforceable standards of service compared to traditional procurement (Bank, Public Private Partnership Reference Guide, 2017).

The World Bank Library monitors activity and trends through its PPI database where it tracks the deals in low- and middle-income countries with 86 billion US dollars of investment in 2023 in 68 countries and according to the OECD Principles the use PPPs only when they generate value when money to combine commitments and contingent liabilities in the budget and to make sure of the procurement is competitive and transparent (Group, 2023)<sup>30</sup>.

PPPs come with challenges and risks. A major concern is the establishment of contingent liabilities and possible financial liabilities in case of poor performance of projects. Many governments have come to know that PPP commitments such as minimum revenue guarantees or termination payments can turn in the future as high expenses particularly when not clearly entered on record and the PPP projects have been renegotiated to benefit the private operator such as by extending concession period or payment increments which in effect transfers more caution back to the government sector (Bank, Public Private Partnership Reference Guide, 2017).

### 2.1.1 Capital Flow Dynamics: Inflows, Outflows and Volatility:

On the subject of the dynamics of capital flows, the PPPs are one of the procedures which appeal to long-term capital inflows and which are stable and directed at development projects. Numerous PPP investments in the emerging markets entail foreign business firms or funders. International capital inflows to the EMs are very procyclical with low prevailing rates and abundant risk appetite, yield-seeking portfolio and bank flows rise. In response to tighter financial conditions or higher risk aversion these flows decline and, in some circumstances caused to the sudden manifestations of risk aversion abruptly in abrupt portfolio outflows

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<sup>30</sup> World Bank Group. 2023 Private Participation in Infrastructure Annual Report.

(Fund, 2023). In macroeconomic terms, the PPP related inflows are generally connected to capital formations and not the speculative activities which is beneficial. They are usually periodic in nature, huge inflows during construction after which more stable operating-period inflows follow since PPP the foreign capital involved in projects is usually long term, the projects are long term and there is little chance of the withdrawal flocking at any given time. Actually, it is possible to consider PPP investments as the subset of FDI concentrated at infrastructure. (Fund, 2023) (Bank, Public Private Partnership Reference Guide, 2017).

At the stage of operations, the PPPs may affect the stable outflow of capital in the host economy as profit resettlement or a form of debt service to foreign lenders. Toll-road concessions financed by foreign are usually transfer operating cash flows to foreign countries in the form of interest on foreign debt and dividends to the non-resident shareholders and in terms of balance of payments these payments are debited in the primary income level of the current account the counterpart to the early inflows of capital that financed the asset (Fund, 2023) . This case is not an issue of remittances as such provided the project increases productivity and welfare and the net issue of policy is to determine the net long-run benefits that is to weigh the discounted flow of anticipated profit repatriation and fiscal contingencies against the economic benefits of the project (Fund, 2023).

Moreover the cause to the potential to tightening of external conditions in a short term where higher interest rates on the global markets or a stronger US dollar and countries risk that outflows related to foreign owned assets increase pressure on the external account and exchange rate particularly where liability is in foreign currency denominations or unhedged (Stiglitz, 2003). The contract design can enable the alignment of private incentives with the public goal as well as reduce external vulnerability risks.

Composition matters, the FDI is the least sticky with portfolio debt/equity, and cross-border bank credit most flight-prone. Flows can represent exterior push factors DM policy, QE/QT, world risk sentiment and domestic pull underlying growth stock, external balances, institutional quality. Since a large proportion of borrowers continue to bear currency mismatches and depend on external financing, frequently short-term, the impact of reversals propagates rapidly into systemwide widening of spreads, FX depreciation, and increased rollover risk (IMF, 2022)<sup>31</sup>. Taper-tantrum example; Following the Fed taper talk in May June

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<sup>31</sup> International Monetary Fund. 2022. Review of the Institutional View on the Liberalization and Management of Capital Flows

2013, EMs experienced a significant capital outflow and bond yields and credit spreads increased, currency depreciated, and cross-border bank lending into EMs declined, particularly to countries with major current-account deficits and high exposure to short-term foreign funds (Takáts, 2014)<sup>32</sup>

Although capital associated with PPP is not generally less volatile to day-to-day market fluctuations compared with portfolio flows, it is not risk-free. The exposure of project cash flows to macro-financial shocks and to sovereign actions is still existing, fluctuations in global financial conditions and increasing risk aversion have historically spilled strongly to the emerging economies, increasing refinancing costs and straining directed public balance sheets that lie behind PPP payment liabilities (Fund, 2023).

Throughout the negative political situation, governments still have strong tools of tax, regulation, and contract reforms, even nationalization can skew returns to. Performance under fiscal stress has been a frequent occasion to reprofiled or renegotiated liabilities so as to relieve short-term cash strains (Fund, 2023). Similar forces can appear in PPPs as availability or tariff-based compensation encumbers budgets, Currency crises present yet another risk to projects that have hard-currency debt or inputs that are valued in foreign currency, increasing the domestic-currency cost of enforcing contracts and making painful adjustments (Fund, 2023). PPPs are typically designed in such a way that they smooth out short-horizon volatility with long-dated contracts, defined payment structures, and indexation or risk-sharing provisions that can confer their cash flows predictability in ways that are not predictable of conventional portfolio investments (Fund, 2023).

## 2.2 Capital Flow Dynamics:

### 2.2.1 Push and Pull Factors Behind Emerging Market Capital Flows:

Capital flows in EMs have a long history of boom bust cycles. A combination of push factors which are the external interest rates, risk sentiment and dollar cycles and the domestic pull conditions which are the policy credibility and institutional quality shape these cycle (Fund,

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<sup>32</sup> Avdjiev, S., et al. 2014. Cross-border bank lending during the taper tantrum. BIS Quarterly Review

2023). It is important to understand the dynamics in order to design policies that would capture the foreign capital and at the same time limit the instability, Inflows, outflows and volatility.

Capital inflows are of various types FDI, portfolio equity and debt, cross-border bank lending and official financing and different in terms of cyclical and risks (Stiglitz, 2003). The inflows enhancement is when the world rates are low with a high level of risk appetite and decrease when the financial environment is tightened\$. The Push and pull factors especially the country growth prospects both the level and the composition of flows are presented by the interaction of the global monetary conditions and the growth of the economy with the risk appetite push and the institutional quality pull (Fund, 2023).

The global Push Factors which consist of interest rates of the world particularly US treasury yields and the risk sentiment around the world measured by the VIX<sup>33</sup> or by investor surveys, the future growth in advanced economies and commodity price cycles (Fund, 2023).

Low interest rates and quantitative easing in developed markets have previously driven more investment into higher yielding emerging market assets which improve inflows. In the other hand EM outflows are more probably occurring in response to US monetary tightening or global risk aversion spikes (Fund, 2023). The EM flows are negatively correlated with the US strength with stronger US dollar is generally connected with capital flows out and constrained financial markets to EM sovereigns and corporates (Fund, 2023). Moreover, the price of commodities counts commodity exporting EMs typically experience inflows in commodity booms and outflows when the market collapses as noticed suddenly in 2015 with the oil exporting emerging markets (Pan, Economic Growth in Emerging Market Countries, 2021).

Domestic Pull Factors are the country specific factors that appeal or displease foreign capital. They contain growth differentials EMs which grow at a larger rate than advanced economies are likely to attract more investment and contain credit ratings and default risk the political stability and governance and openness of capital account (Fund, 2023). Nations that have better experiences of reform as an example in India following liberalization in the 1990s or Vietnam more recently have attracted strong inflows even in less favorable global circumstances (Fund, 2023). However, the sudden outflows have been affected by policy mismanagement and political crisis as seen in recent years in Turkey and Argentina (Fund, 2023).

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<sup>33</sup> VIX: CBOE Volatility Index

A significant new pattern is the role of geopolitical alignment when increased geopolitical risk has set up a bias in which investors prefer location that emerge to have a geopolitical hedge or belong to their home bloc, IMF evidence has demonstrated since 2018 that FDI flows have become biased towards geopolitically closer destinations and the invasion of Ukraine by Russia has increased the risk aversion of investors towards higher risk jurisdictions (Fund, 2023).

### **3. Short- and Long-Term Effect on Host Economies:**

The short- and long-run effect of host investments and capital flows is varied on foreign economies. It is important to differentiate between the effects to formulate policies that maximize developmental benefits and downplay practicable vulnerabilities.

#### **3.1 Short Term Effect:**

The capital inflows in the form of FDI or portfolio investments and other forms have provided a significant source of external financing which is stimulatory to economic activity in the short run (Wich, 2012). FDI regularly funds tangible projects for instance building new plants, service networks or acquiring local firms which in turn lead to a quick spurt in construction activity and imports of both intermediate and capital goods and local employment (Wich, 2012).

Licensing fees and taxes imposed on these new activities may also have short-run benefits to governments in terms of fiscal revenues. By contrast, the portfolio inflows have the tendency to be concentrated into equity and bond markets and this raises the cost of assets, reduces yields and lessens the cost of borrowing to the firms and the government as well. This may produce a short-term wealth effect and enhance both consumer and business confidence since the increase in equity valuations guide to a better liquidity in the market which makes it easier to spend and invest (Fund, 2023). To governments with deficits, the foreign acquisition of sovereign bonds will provide them fiscal space to fund spending without crowding out local investors.

Short term inflows are more likely to appreciate the domestic currency, as foreign investors will be required to exchange all their money into domestic currency. A certain immediate payoff of this appreciation where imported goods become cheaper which assists to decrease inflationary pressures and households will increase purchasing power since their income

extends further to foreign prices, it is less pricy to service such foreign-currency debt in the short-run by governments when the high or long-term appreciation is quite risky (Stiglitz, 2003) (Wich, 2012). An increase of currency reduces the competitiveness of the exports in the host countries since goods that are produced locally will be more costly compared to the foreign ones, this effect has the potential of undermining competitiveness of manufacturing and tradable industries, a process commonly referred to as the Dutch Disease (Stiglitz, 2003) (Wich, 2012).

To illustrate, in the year of 2010s Brazil was experiencing a commodity boom which meant that capital inflows had soared and the wealthy resource incomes were driving up the real which undermining the competitiveness of industrial exports (Pan, Economic Growth in Emerging Market Countries , 2021). In the same case, Turkey appreciated the time of lira increase when the inflow of the funds in the portfolio was fast and effectively enhanced consumer spending but then put the exporters at a loss as the global situation became tight (Omar Costa, 2014). These cases show how the currency appreciation is a two-sided development.

The dynamic outlined in the above sections can be demonstrated by taking the case of the relationship between inflows in the portfolio and GDP growth in the chosen emerging economies. The next figure involves a comparison between Turkey, Brazil, and Indonesia during 2010 and 2020 whereby the capital flows were procyclical.

**Figure 5: Portfolio Inflows and GDP Growth in the Region of Turkey, Brazil and Indonesia 2010-2020**<sup>34</sup>

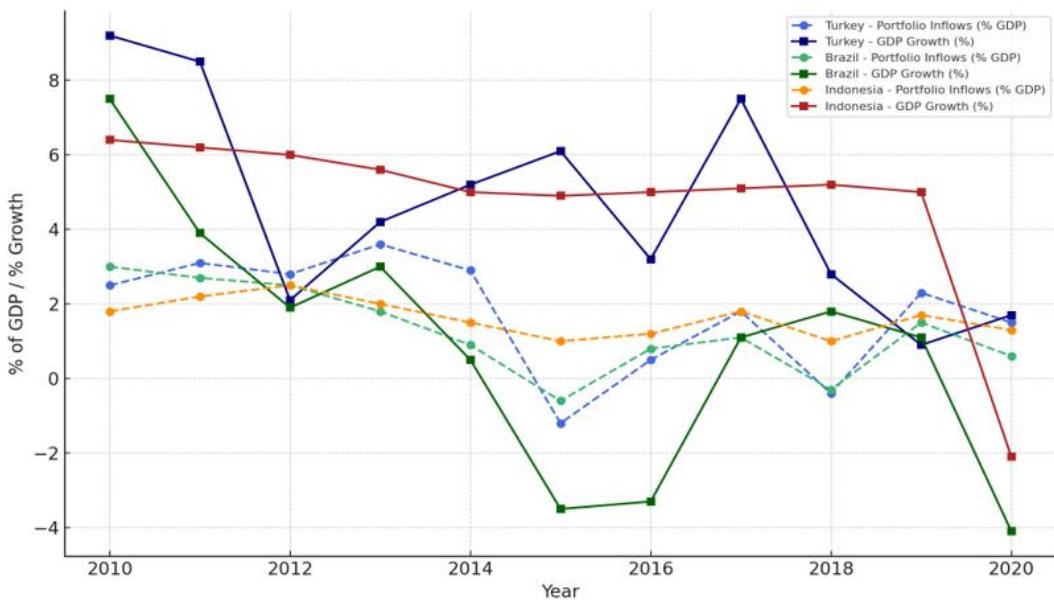


Figure 5 is a comparison between portfolio inflows and GDP growth in Turkey, Brazil and Indonesia in the period between the year 2010 and 2020. The patterns verify that capital flows are highly procyclical in emerging markets where the inflows have a positive growth tendency during booms and a significant decrease during slowdowns. In Turkey, the largest inflows of portfolio flows occurred in 2010 and 2011 and in 2016 and 2017, which were accompanied by higher growth rates, a sudden falls in 2013 and 2018 were succeeded by rapid decelerations. This volatility is indicative of the high reliance of the country on short term external funding as well as its susceptibility to changes in global liquidity situation (Fund, 2023).

In Brazil the inflows have exerted a strong growth in the early years of 2010s, yet these flows were stopped in 2014 and 2015 which together with the domestic political and fiscal turmoil, led to a severe recession.

Indonesia is more resilient where the portfolio inflows were also unstable, but the GDP growth was rather fixed and ranging between 5 percent during the majority of the decade. This indicates that Indonesia was in a better position to respond to external shocks as compared to

<sup>34</sup> The graph is from the data that is based on trends presented in the IMF World Economic Outlook (2023), Chapter 4: Geoeconomic Fragmentation and Foreign Direct Investment.

Turkey or Brazil since it is stronger in macroprudential structures and a more robust domestic market.

The evidence in general, points to a core trade-off, the portfolio inflows may drive short-term growth but scale up the macroeconomic volatility and the level of exposure varies with structural and institutional features (Fund, 2023) (Wich, 2012).

Besides the affecting exchange rates and the volatility of growth and short-term capital inflows are restructuring domestic financial environments and contributing frequently to credit and asset booms that increase vulnerability, rapid credit growth and price inflation of assets are usually presented to accompany inflow surges as banks with access to host funds are more aggressive in drawing new credit (Stiglitz, 2003). The consumers obtain lower loans and firms fund expansion at reduced costs and generating short-lived spurts in production (Stiglitz, 2003). capital flows may suddenly reverse to cause destabilizing effects where a sharp outflows reduce the value of assets, undermine currencies and force central banks to increase interest rates, thereby tightening the credit environment and slowing down activity and the domestic banks that are relying on foreign credit lines could experience a liquidity crunch and firms using foreign-currency debts can go out of business (Omar Costa, 2014).

### 3.2 Long Term Effects:

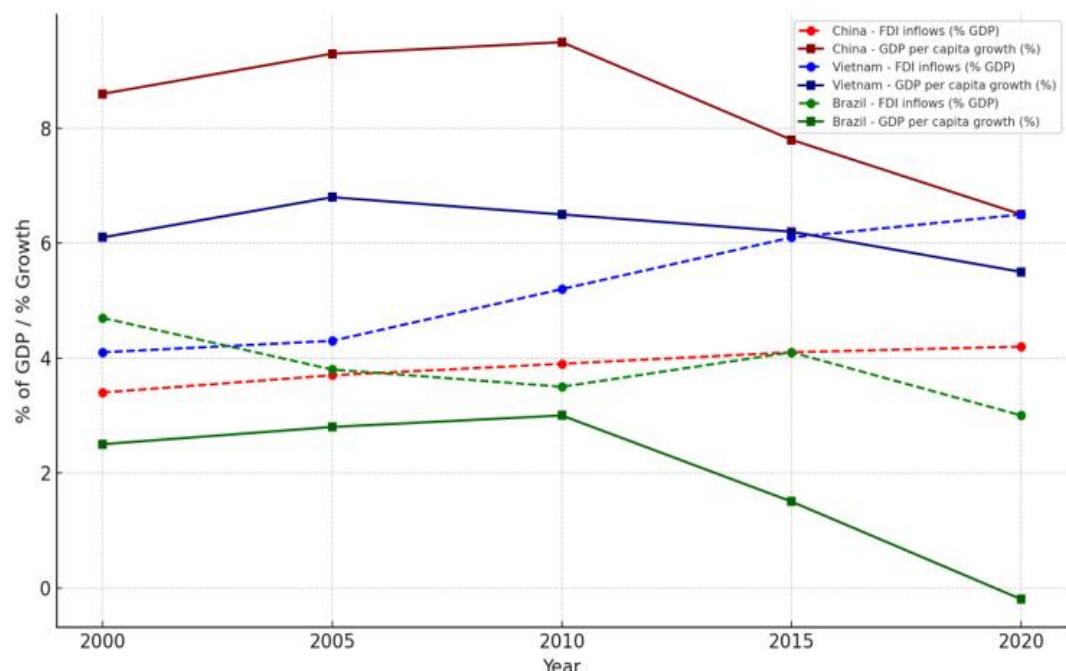
In the perspective of a long-term effect, the host investment may have a deep influence on the development path of a host economy where the long-term inflows of FDI strengthen the productive potential and growth potential of an economy or bringing new technologies and integrating firms into international value chains (Wich, 2012). Economies in many parts of East Asia such as Malaysia, China, and Vietnam took advantage of the waves of manufacturing FDI to industrialize and resort to export led growth over decades (Wich, 2012).

The net effect of this kind of investment is long-term productivity, structural change and increase in exports, better management, and increased innovation. As a result of competition with foreign companies the IMF has recorded that the spillovers are not equally distributed and nations with complementary characteristics like human capital, absorptive capacity, and institutional quality are likely to experience the greatest, whereas others experience lower returns (Fund, 2023). The foreign capital has tended to boost enclave industries and yield profits that are repatriated to other countries in large amounts, with minimal permanent

contribution to the growth of the overall economy as a reminder that FDI is not always a growth-inducing phenomenon unless it is coupled with domestic development planning (Fund, 2023).

The above tends that are presented can be demonstrated by contrasting FDI inflows with GDP per capita growth in the chosen emerging markets. China and Vietnam are noted in Figure 6 and unlike Brazil where sustained inflows led to structural change and long-run growth.

**Figure 6: FDI Inflows and GDP Per Capita Growth in Vietnam, China and Brazil 2000-2020**<sup>35</sup>



<sup>35</sup> Figure 6 is elaboration based on IMF (2023) and Wu & Pan (2021).

As indicated in the figure 6 where the long-term effect of FDI is less reliant on the actual number of inflows but rather the degree to where it is taken up and connected to the local economy. Over the years of 2000 and 2020, FDI inflows in China averaged around 4 percent of GDP corresponding with a steady high growth rate of per capita of more than 6 percent.

In addition, the Vietnam had inflows at 4 to 6 percent of GDP and its GDP per capita growth was averaged at 5 to 7 percent, which present that the continuous foreign investment in manufacturing contributed to export-oriented industrialization and increased productivity.

Brazil have the same FDI at an average of between 3 and 4 percent of GDP, but per capita growth was significantly lower between 1 and 2 percent and even became negative in recessions 2015 to 2020. Brazil had a high concentration in extractives and low productivity sectors.

Portfolio investment has an indirect effect which is more on the long run, in the modulation of financial markets foreign investors are associated with intensifying liquidity in the market, increasing the disclosure standards and encouraging companies to implement more potent governance practices. In the long term such enhancements will expand the range of investors decreases the price of capital structure and make the whole environment more favorable to innovation and entrepreneurship (Fund, 2023). Another advantage is the disciplinary impact, governments know that fiscal or monetary mismanagement will punish by increasing the bond spreads or by flight of investors, but such learning is not purely good and during bad periods a tightness of fiscal or monetary policies can also be caused by market pressure thus increasing recessions (Stiglitz, 2003).

Foreign capital risks in the long run are better during the poor management of integration, the effect of this is that economies which depend continuously on inflows to finance fiscal deficits frequently end up with unsustainable burdens of external debt and such a dependence exposes growth changes the international liquidity and the moods of investors. Without external capital, the countries that rely on foreign savings, as Malmgren warns can become isolated and cannot develop (Malmgren, 2015)<sup>36</sup>. Add to that, the recurrent boom bust cycles caused by unpredictable flows of portfolios can leave permanent mark upon host economies and lost output in times of crisis is usually never recovered in full and the financial crisis is devastating

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<sup>36</sup> Pippa Malmgren. 2015 Geopolitical for Investors. The CFA Institute Research Foundation

productive capital and confidence. The remedies by governments of bailouts and stabilization tend to increase the levels of public debt for instance in the Latin American debt crises of 1980 and the Asian financial crisis of 1997 and 1998 are examples of historic moments when dependence on external capital combined with ineffective financial regulation has transformed a temporary surge of volatility into structural harm (Stiglitz, 2003).

The short- and long-term effects of foreign capital are very ambivalent when taken together. FDI and portfolio flows may boost growth, increase credit and increase consumption in the short term but it increases susceptibility to abrupt terminations. Long-term inflows can generate structural change, deep financial market, and institutional capacity only under the condition of supportive policies and governance structures (Fund, 2023). In their absence, dependence on external finance will result in the dependency on debts, periodic crises and imbalanced development. The emerging markets points to one of the main lessons which foreign capital is not a sure driver of growth or a predetermined engine of instability but, in fact it's a two sided tool, the effectiveness of which is determined by the ability to manage, regulate and channel it by the host economies (Stiglitz, 2003).

# Chapter 3 Emerging Markets: China in Africa

Emerging markets have not merely been economic opportunities space, but they are also becoming strategic where global powers exercises influence via infrastructure, capital flows and policy conditionality. As (Stiglitz, 2003) presented, globalization has uneven results where some of the nations have been able to use openness and foreign investments to accelerate their growth but there are some have been volatile, dependent and experienced growing disparities. Such diversification paths are not just conditioned by economic formations, but it has been also conditioned by geopolitical policies, in which investments are becoming a statecraft in its own right.

China's Belt and Road Initiative in Africa, a geopolitical oriented and infrastructure base approach to access to securing resources and strategic influence.

## 1.China's Belt and Road Initiative in Africa:

### 1.1. Economic and Geopolitical Framework:

The Belt and Road Initiative BRI, declared by the president of China Xi Jinping in the year of 2013, has been commonly portrayed as one of the most ambitious out bounding economic policy of the people republic of China, that has incorporated a Belt traversing the continent and a maritime Road to enhance connectivity in both trade and infrastructure across Asia, Europe and Africa. The initial reporting framed BRI with approximately 67 countries, 4.4 billion population with 63 percent of the worldwide and 29 percent of global GDP with a specific financing vehicles such as the Asian Infrastructure Investments Bank with 100 billion dollars in subscribed capital and the Silk Road Fund with 40 billion (Changfeng, 2016)<sup>37</sup>.

The involvement of Africa in the early BRI framework was limited to some countries, but some were specifically chosen due to their geographic positioning and out of the 67 countries, three countries are described as core nodes: Djibouti, Egypt and Kenya are chosen by their strategic geographic position but not their market size, Egypt is considered essential due to the Suez

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<sup>37</sup> Raphael ZiroMwatela & Zhao Changfeng. 2016 Africa in China's 'One Belt, One Road' Initiative: A Critical Analysis

Canal, Djibouti is the entry point to the Red Sea with approximately 30 percent of world shipping transits and Kenya holds the Indian Ocean to Hinterland nexus, even without proclaimed a BRI member due to its ability to take South Sudan (Changfeng, 2016).

Beijing does not just describe Belt and Road Initiative as an economic choice, but it is a base on the principles of sovereignty, equality, non-interference and reciprocity. These values were associated by China with the Bandung conference in the year of 1955 and used this concept to position the BRI as a South-South solidarity and to set it apart in terms of conditionality based approach of organization for economic cooperation and development OECD donors and international financial institution (Changfeng, 2016). Therefore, through focusing on principles of shared gain and collaboration, China was able to establish itself as an equal to other developing nations instead of becoming a monopolist who pushes external solutions, and emphasizes that engagement in the BRI is not associated with advanced political concessions (Breuer, 2017)<sup>38</sup>.

The ideological placement permits Beijing to position the BRI as a credible developmental option in Africa .It is considered as an alternative to Western dominated aid and lending models that are generally requires financing to be conditional on governance or human rights standards, and by reducing the advanced political terms (Breuer, 2017) . China is not only developing the economic activity but they have expanded their geopolitical power and the infrastructure finance are more flexible and adaptable, it is applied by government to governments structure meaning they are frequently supported by Chinese policy banks especially the Export Import Bank of China “EximBank” and severed trough deals where the financing, EPC<sup>39</sup> contracting are performed by the Chinese parties (Breuer, 2017).

Furthermore, the absence of political strings does not mean there are no conditions and terms, the symbolic agreements such as the Angola model<sup>40</sup> with the requirement that most of the infrastructure contracts must be procured by the Chinese firms are expressions of an economic as opposed to political obligation (Breuer, 2017).

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<sup>38</sup> Julia Breuer .2017 Two Belts, One Road? The role of Africa in China’s Belt & Road initiative Blickwechsel.

<sup>39</sup> Engineering, procurement and construction

<sup>40</sup> the Chinese tradition of issuing resources secured loans, with oil rents designated as security and the majority of infrastructure contracts given to the Chinese companies as an expression of economic not political conditionality.

## 1.2. Strategic Importance of Africa in the BRI and the Key Projects:

### 1.2.1 Strategic Importance of Africa:

The choice of Africa being a part in the Belt and Road Initiative is influenced by a combination of geographic, economic and political strategic factors.

Geographically, the continent is strategically located in the world trade, the coastline of East Africa creates a significant route in the Maritime Silk Road since it provides intermediaries for the Chinese marine trade towards the Middle East and Europe, Egypt in particular cannot be replaced since it has officially become a part of the BRI in 2016 and served as an anchor of the Chinese connectivity policy by controlling the Suez Canal which is one of the transit point that the major part of China and Europe (Changfeng, 2016).

In addition, the horn of Africa is strategically positioned at the Bab el Mandeb Strait which is the southern entrance to the red sea where the same shipping that enters the Suez Canal passes with as estimated 30 percent of the world wide transit, Djibouti is now the center of the Chinese plan where the Doraleh that came into operation in 2017 by the Chinese and presented as multipurpose port connected to the 750Km Addis Ababa Djibouti railway, allowing the entrance point to Ethiopia, and in the same year China opened its first foreign naval base with highlighting both economic and security value of Djibouti although the relatively small domestic market and approximately 9.8 billion dollars was invested by the Chinese in Djibouti under the BRI (Breuer, 2017) (Changfeng, 2016).

Economically, Africa is considered a good choice due to its appealing natural resources and to the frontier market, the continent is rich in oil, gas, minerals and agricultural lands which are important to the long term resources security of China and the access to these resources are facilitated by infrastructure investments under the BRI, as an example the Lamu Port South Sudan Ethiopia Transport Corridor LAPSSET which consists 27 billion dollar port project at Lamu, a 25 billion dollars modernization of its railway network, and 4 billion dollars oil pipeline, all of which provides an exit point to the inland resources of South Sudan and Uganda to the Indian Ocean, therefore this route will help to decrease dependency on the pipelines in Sudan and spreads Chinese importation pathways since South Sudan accounts approximately around 75 percent of the oil resources of the once united Sudan (Changfeng, 2016)<sup>41</sup>.

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<sup>41</sup> Daily Nation, March 6, 2016

Meanwhile, the 1.3 billion population (World Bank Group, 2021)<sup>42</sup> and urbanization rate of Africa present and attractive market of the Chinese products and services.

The Chinese firms are supported by the state policy where they have become a leading players in the filling Africa infrastructure shortages in areas such as energy transportation, and telecommunication and positioning themselves in the position to take benefits from the continent future growth (Breuer, 2017). Meanwhile, the establishment of industrial parks and special economic zones including the Eastern industrial zones near Addis Abab presents the strategy of the Chinese intention to move a part of its manufacturing to Africa, and allowing Beijing to benefit from cheap labor costs and connect the local industries to the Chinese global supply network (Breuer, 2017).

Politically and strategically, the BRI had helped China to spread its influence in Africa where region has been historically dominated by western powers and international financial institutions, also the 54 states that forms the African continent allows Beijing a diplomatic bargaining power and more economic involvement would result in voting support or opposition as per Chinese attitudes since Africa present a large voting bloc at the United Nation General Assembly (Breuer, 2017). The One China policy is promoted by almost all the African government which strengthens the Beijing diplomatic moves to isolate Taiwan on international fronts (Changfeng, 2016).

China is able to build goodwill through the BRI projects that are used in arguments about reforming world governance to give more say to the developing nations, besides economics, Beijing had supplemented its infrastructure diplomacy with security cooperation such as troop contribution to United Nations peacekeeping missions, military training and selling arms (Breuer, 2017). Overall, the infrastructure diplomacy, development finance and security cooperation makes Africa a major platform and one of the main arenas of China to exercise soft and hard power.

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<sup>42</sup> World Bank Group. Population, Total – Sub-Saharan Africa

### 1.2.2 The Major BRI Projects in Africa:

The BRI involvement in Africa encompasses a wide range of infrastructure sectors, ranging from railways and ports to energy facilities and industrial zones. The table 1 below summarises a selection of flagship BRI projects across the continent.

**Table 1: Key Projects**

Projects	location	sector	Estimation	Financing & Significance
Cost in USD				
<b>Mombasa Nairobi SGR 470 Km</b>	Kenya	Transport Railway	3.8 to 4.7 billion	90 percent EximBank loan. Manufactured by CCCC <sup>43</sup> . Core East African corridor (Breuer, 2017) (Changfeng, 2016)
<b>Addis Ababa Djibouti Railway 756Km</b>	Ethiopia	Transport Railway	4 billion	85 percent EximBank loan. Manufactured by CRCC <sup>44</sup> . 90 percent of Ethiopia trade and secures port access (Breuer, 2017) (Bank, 2019)
<b>Abuja Kaduna Railway</b>	Nigeria	Transport Railway	876 billion	Build by CCECC <sup>45</sup> . First phase of national rail modernization (EximBank and Nigeria government) (Breuer, 2017) (Bank, 2019)
<b>Doraleh Multipurpose Port</b>	Djibouti	Transport Seaport	580 billion	EximBank loan and CMG <sup>46</sup> . Manufactured by CCECC. Strategic hub near Bab El Mandeb (Breuer, 2017)

<sup>43</sup> CCCC: China Communications Construction Company, one of China's largest state-owned enterprises (SOEs)

<sup>44</sup> CRCC: China Railway Construction Corporation

<sup>45</sup> CCECC: China Civil Engineering Construction Corporation

<sup>46</sup> CMG: China Merchant Group

<b>Lekki Deep Sea Port</b>	Nigeria	Transport Seaport	1.5 billion	CDB <sup>47</sup> loan and CHEC <sup>48</sup> equity. Expands Lagos as the West Africa biggest port (University, 2025)
<b>Karuma Hydropower Plant 600MW</b>	Uganda	Energy	1.7 billion	85 percent EximBank loan. Manufactured by sinohydro. Increase Uganda capacity of power (Breuer, 2017)
<b>Zugeru Hydropower Plant 700MW</b>	Nigeria	Energy	1.3 billion	EximBank and CDB loan. Manufactured by sinohydro. Increase capacity of electricity (Bank, 2019)

### 1.3 Economic and Financial Impact:

The BRI by China has enhanced the investment financing envelope in Africa with Quantifiable impact on trade, investment, growth and debt sustainability. Although the initiative has created significant development opportunities it has increased financial vulnerability (Bank, 2019)<sup>49</sup>.

The BRI infrastructure projects had a major impact on Africa China Trade relations, making China the largest trading partners of Africa since 2009. In 2020, this pattern was interrupted by the COVID 19 Pandemic when the level of the total merchandise trade decreased by 176 billion dollars. However, in 2023 trade recovered to 262 billion dollars, followed by a record high of 254 billion dollars in 2021 and 2022 respectively (University, 2025)<sup>50</sup>.

The structure of this trade present that there has always been imbalance where China has been exporting more to Africa than it has been importing, and the trade imbalance has continuously increased to the benefits of China (Bank, 2019).

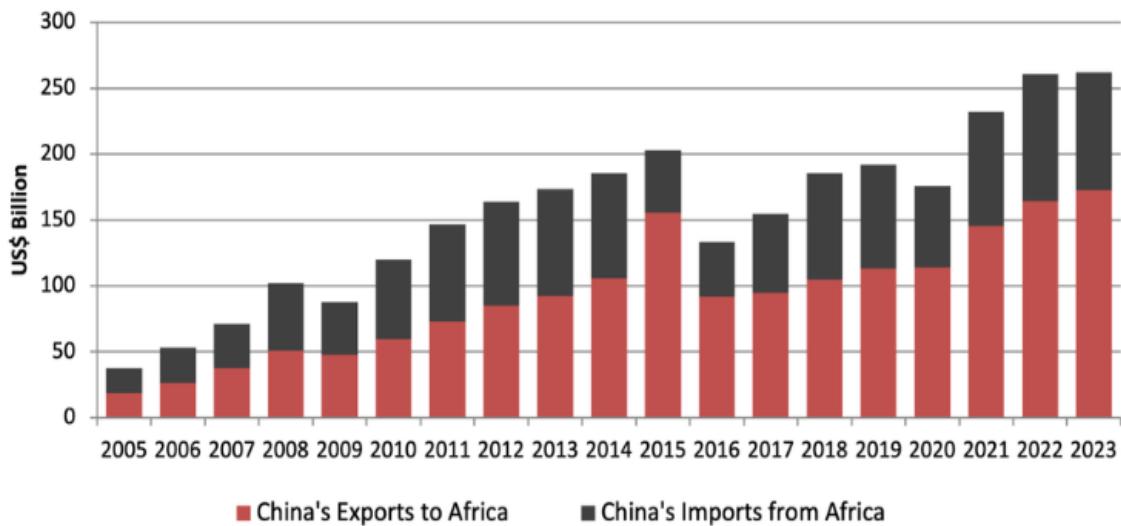
<sup>47</sup> CDB: China Development Bank

<sup>48</sup> CHEC: China Harbour Engineering Company

<sup>49</sup> World Bank Group. 2019 Belt and Road Economics: Opportunities and Risks of Transport Corridors. Washington

<sup>50</sup> Johns Hopkins University. 2025 China Africa Research Initiative Washington

**Figure 7: China-Africa Trade 2005-2023**



Source: UNComtrade CARI, Sep 2024

Furthermore, China and Africa have increased more than twenty in the last two decades and increased with a value of 40 billion dollars to 260 billion dollars by 2005 and 2023 (University, 2025)<sup>51</sup>. This growth is an indication of China perpetual need of Africa raw materials and how Africa is dependent on Chinese manufacturing products.

The infrastructure had been improved that led to have reduced transport costs and logistics since the RBI, the Mombasa Nairobi Standard Gauge Railway (SGR) decreased the shipment transit time less than ten hours and the Ethiopia Djibouti Railway now transport approximately 90 percent of Ethiopian trade which make it competitive and reducing the cost of shipment (Breuer, 2017) (Changfeng, 2016) and the combination of these examples demonstrates how BRI transport projects may redefine the logistics of national and regional trade, lowering the costs and delays, to enhance the competitiveness of Africa on the global markets. The world bank at the macro level, estimates that on average the investments in transport corridors could help to cut down trade costs in Africa by an average of 16 percent and in Asia approximately 12 percent and only 2 percent in the other parts of the world, these cuts are being estimated to translate into 3 to 10 percent growth in trade over the base and GDP growth to 3.4 percent by 2030 which reinforce integration of Africa in the global economy (Bank, 2019). This type of

<sup>51</sup> Johns Hopkins University. 2025 China Africa Research Initiative Washington

efficiency will support the performance of African continental free trade area which will rely on the enhanced cross border logistics to realize its full potential (Development U. N., 2021)<sup>52</sup>.

The Chinese Foreign Direct Investment FDI has increased in line with trade but it is relatively small when contrasted to the western inflows, in 2003 the level of Chinese FDI flow reached 75 million dollars before increasing in 2023 to around 4 billion dollars with a peak of 5.5 billion dollars in 2008 due to acquisition of the standard bank by the industrial and commercial bank in China (University, 2025).

Despite the increase FDI African investment through Chinese, it has not pushed out the western investment, as in 2023 the United States FDI outflows to Africa were to approximately 7.8 billion dollars and with approximately 4 billion dollars outflows to China meaning the BRI related investment has not replaced completely replaced other capital inflows (University, 2025). Simultaneously Board and Road initiative projects has presented African companies an opportunity to connect to global supply chains and other foreign investors in the goal to gain access to lower infrastructure and logistic costs.

The greatest potential of BRI is the fact that it will boost long term growth by enhancing productivity and connections, in Kenya a growth in GDP was attributed by the government when the opening of Mombasa Nairobi Standard Gauge Railway has been contributed to the effectiveness of logistics and increased efficiency in trade and in Ethiopia the Addis Djibouti Railways along with the Chinese financed industrial zones are expected to increase manufacturing exports such as textiles and decreasing the price of imports such as fuel (Bank, 2019) (Breuer, 2017).

The belt and road economics study by (Bank, 2019) estimates that when fully enforced, the investment of BRI transport corridors will increase the aggregate of GDP of Africa by approximately 3.4 percent by 2030 as compared to 2 percent globally, these benefits are most likely to be achieved through reduced trade costs, improvement in efficiency and increase regional integration. Moreover, the infrastructure projects have a short-term demand impact including construction employment and local procurement and long-term supply impacts including electricity accessibility and lower logistics.

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<sup>52</sup> African Continental Free Trade Area for Inclusive Growth. 2021 United Nations Conference on Trade and Development Geneva.

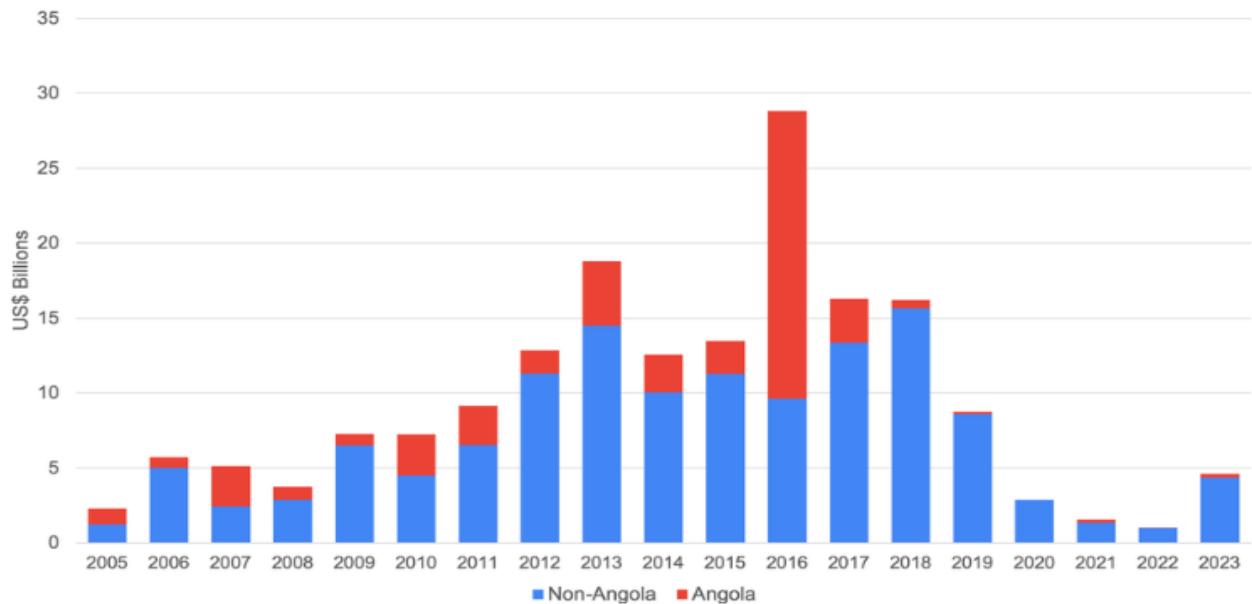
The growth dividend does not automatically come, project utilization, institutional capacity and complementary policies have a significant importance in the outcomes, these projects that run below capacity like Kenya SGR during its initial years where cargo volumes are lower than anticipated and are likely to bring less economic benefits as projected, also there is cross country evidence that the Chinese infrastructure finance is positively correlated with African growth, it has shown that 10 percent growth in Chinese infrastructure investment is related to 1 percent growth in GDP per capita in recipient nations but no longer causality is established (Bank, 2019).

These facts indicates that BRI investments have the potential to deliver short term and long-term growth advantages through reducing expenditure and by increasing productivity potential, they are achieved through making sure that the projects are properly utilized and are financially sustainable and taking a part of the larger national and regional development strategies.

As the BRI has enabled to mobilize historic amount of money to fund African infrastructure, it caused concerns about debt sustainability, where during the years of 2007 to 2020 the two principal policy banks in China which are the China EximBank and the China Development Bank has provided approximately 23 billion dollars in loan to the infrastructure projects in Africa, which are more than the accumulated lending of the eight largest lenders including the World Bank and the African development Bank (Bank, 2019).

Figure 2 illustrates that Chinese loan obligations also hit their highest point in the year of 2016 with proximately 30 billion dollars with most as oil backed loans to Angola and then it had collapsed in 2018, in the years of 2021 and 2022, new commitments had reached an all-time low cause by growing debt distress level in African economies and Beijing domestic demands limiting lending (University, 2025).

**Figure 8: Chinese Loan Commitments to Africa**



Source: CARI/BU, May 2025

Through the concept of dept-trap diplomacy controversy, the evidence that indicates that the primary risks do not arise out of predatory intent but its rather concentrating exposure, weak debt management systems and limited ability of certain African economies taking high size loans, this highlights the role of clear terms of loans, improved debt management procedures and diversification of funding sources so that BRI investments and projects are effective in creating sustainable growth rather than fiscal strain (Bank, 2019) (Breuer, 2017).

#### 1.4 Geopolitical and Strategic Dimensions of China's BRI Engagement in Africa:

The China Belt and Road Initiative in Africa is more than infrastructure and trade, it is deeply ingrained in the geopolitical calculus of the continent. Through massive funding and tactical security alliances as well as diplomatic overtures, the project has redefined Africa in the international power politics and transformed the trend of regional affiliations.

Geopolitical tensions between Beijing and the traditional western players have intensified due to the spread of China BRI in Africa, the western governments are becoming more and more aware that China infrastructure financing, concessional lending and port development are the means through which economic power can be transformed into political power, experts observe

that this dynamic is a larger clash between the Beijing agreement that includes non-interference and trade oriented development and the Washington agreement where assistance is conditional on governance and human rights (Breuer, 2017) (Raphael ZiroMwatela, 2016).

Africa has emerged as a conspicuous stage of strategic competition between China and the West in which the governments are very careful to strike a balance between competing offers, such competition may increase the availability of funds and provide African states with more bargaining power, it leads to new pressures to place itself on one side of the politically sensitive matters, they include technology decisions like vote over Huawei 5G networks to diplomatic politics in multilateral forums, like voting patterns in the United Nations (Breuer, 2017) (Fund, 2023).

One of the critical geopolitical events of the Chinese African engagement was the introduction of its first foreign military base in Djibouti in 2017, which signified the shift of the People Liberation Army Navy to a blue water posture, formally, the base has been characterized as a logistics base in aiding antipiracy patrols in the Gulf of Aden, however, the base has taken control of China in the immediate neighbourhood commercial interests of the greatest significance the Chinese-owned Doraleh Port and also imposes its own influence along the Bab el Mandeb strait, a vital shipping chokepoint through the Suez Canal (Raphael ZiroMwatela, 2016) (Breuer, 2017) (Pan, 2021).

China footprint on security is also not limited to the basing rights, it is emerged as a major arms dealer to African nations including Nigeria, Tanzania and Sudan and also trains African officers in Chinese academies and China has become one of the biggest sources of manpower to the UN peacekeeping forces among the permanent members of the Security Council, and thousands of people Liberation Army soldiers are sent to areas of South Sudan, Mali and the Democratic Republic of Congo (Breuer, 2017) (Raphael ZiroMwatela, 2016). Therefore these changes highlight that China African role is no longer an economic affair but is now more of a security aspect to focus on protecting nationals, protecting investments, and influence security governance in the region (Breuer, 2017) (Raphael ZiroMwatela, 2016).

China has institutionalized political relationships and project soft power into Africa using the BRI, the FOCAC offers a permanent conduit of high level coordination, whereas the connections to the African Union Agenda 2063 incorporate BRI discourses of South-South collaboration and connectedness in continental planning; Simultaneously, quantitative studies

of voting patterns in the UN General Assembly like the Bailey Strezhnev Voeten data<sup>53</sup> show that in case of sensitive or profile issues, many African countries shift their votes towards China, this indicates that economic interaction by the BRI can be supported by diplomatic convergence although the level of this convergence differs significantly across nations and individual resolutions (Breuer, 2017) (Fund, 2023).

strategy employed by China to supplement its economic involvement is the heavy investment on a soft-power strategy. The imperial court, with the aid of state media outlets like CGTN and Xinhua, the creation of Confucius Institutes in African universities, the intensive scholarship programs, establishes linguistic, cultural, and professional connections between the African societies and Beijing (Changfeng, 2016). African impressions of China are mostly positive, which is confirmed by the survey evidence where an Afrobarometer survey<sup>54</sup> released in 34 countries in the years of 2019 and 2021 revealed that 60 percent of the participants had a positive perception of the impact of China on them in contrast percent of participants had a positive perception of the impact of the US (Breuer, 2017) (Changfeng, 2016).

Such positive images are commonly associated with the existence of Chinese-financed infrastructure and the increased trade prospects. However, there are still anxieties in certain situations about job competition, the quality of products and the environmental effects. These efforts allow China to transform its economic imprint into diplomatic capital and agenda setting power not only at the regional level, but also at the multilateral level (Breuer, 2017) (Changfeng, 2016).

The BRI in Africa is not just an economic project, but a larger geostrategic game and the rearrangements of power. China has established a presence and leverage, never before seen by a non-Western power in modern times, portraying itself as a partner of Africa in terms of key infrastructures and developmental proponent. This has resulted in strategic realignments among other external players and placed Africa as a major platform to the competing visions of development and governance, China state led model versus Western focus on democracy, transparency, and conditionality. according to Africa scholars BRI involvement has broadened the financing options and increased bargaining power, but it has also brought novel issues of how to handle outside influence and protect sovereignty (Breuer, 2017) (Changfeng, 2016).

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<sup>53</sup> the Bailey Strezhnev Voeten: UNGA dataset as a standard measure of international voting alignment.

<sup>54</sup> Afrobarometer survey is a non-partisan survey network conducting nationally representative polls across Africa.

## 1.5 Criticism and Risk of BRI in Africa:

The BRI was introduced to African Leaders as a means of addressing infrastructures gaps. However, it has brought some criticisms and debates over potential drawbacks, especially concerning debt sustainability, sovereignty, social and environmental impacts.

The BRI Chinese financing runs the risk of causing debt traps in Africa where developing countries end up with impractically high debt burdens potentially undermining their fiscal integrity or even sovereign status. Number of African countries have taken substantial liabilities to Chinese lenders, which places them at risk of servicing such debts in the long term and in the worst case, they could be held at the mercy of their Chinese creditors, potentially to provide control over their strategic choices or even actual possession of important infrastructures (Breuer, 2017) (Ehizuelen, 2017)<sup>55</sup>. T

he most cited case used in the presentation of the debt trap diplomacy is the Hambantota Port in Sri Lanka, in 2017 was leased to a Chinese state owned corporation around 99 years since the project did not generate enough revenue to cover the cost and the government was going through increasing debt distress and the port that was built by the Chinese loan became a political and financial liability in that area which made Sri Lanka to accept 1.1 billion dollars concession deal with China Merchant Port Holdings. (Breuer, 2017) (Ehizuelen, 2017).

March 2018, the US secretary of State Rex Tillerson declared a warning to African government in Addis Ababa press conference about the possibility of danger of predatory lending practices that can generate control over strategic assets (U.S. Department of State , 2018)<sup>56</sup>. In the other hand Beijing denies the debt trap story citing its historical experience of restructuring and rescheduling debts and the taking part in the G20 Debt Service Suspension Initiative during the pandemic (Fund, 2023).

The environmental and social impact of BRI projects in Africa, where a large infrastructure is able to disturb the ecosystems. The proposed Lamu Coal Power Plant project in Kenya region has caused an opposition from the society and environmental groups that argued that this

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<sup>55</sup> Michael Mitchell Omoruyi Ehizuelen. 2017 More African countries on the route: the positive and negative impacts of the Belt and Road Initiative. China

<sup>56</sup> U.S. Department of State. (2018, March 8). Remarks by Secretary of State Rex Tillerson at a press availability in Addis Ababa, Ethiopia.

project will destroy a UNESCO<sup>57</sup> World Heritage site and destroy the Kenyan renewable energy policies (Breuer, 2017) (Changfeng, 2016).

Moreover, social issues to the forefront with Chinese corporations being accused of poor labour standards, low wages and the presence of conflicts between Chinese workers and local employees as well as acts of strikes at mines operated by Chinese in Zambia have demonstrated these clashes and about 200 000 Chinese employees working in Africa has brought debates in high unemployment countries (Breuer, 2017) (Ehizuelen, 2017).

China has enhanced its mass diplomacy focusing on the practical advantages of BRI project port such as employment opportunities and increasing the connectivity as it compares its concept of non-interference with the Western conditionality (Breuer, 2017).

## 1.6 The Belt and Road Initiative as a Geopolitical Instrument:

The BRI is now seen as a development strategies and as a geopolitical tool that is changing the alignment of the globe. The projects that are created in Africa such as the SGR in Kenya and the Suez Canal Corridor in Egypt, demonstrate the infrastructure investment can generate an increase in the economic relationships and enhance the strategic access of the Chinese into the maritime chokepoint that was initially controlled by the Western (Pan, 2021). In the current geoeconomic fragmentation this competitive advantage is magnified, in the United States and its partners are rearranging the supply chains to decrease the reliance on China and encouraging the Friend Shoring (Fund, 2023).

The BRI has increased connectivity and fixed the financing gaps, however it has brought concerns on the reliance on debt, sovereignty and the potential to weaponize critical infrastructure as a tool to obtain a diplomacy or military dominance (Raphael ZiroMwatela, 2016). Therefore, the BRI is now discussed to be no longer a neutral development platform but becoming an instrument to gain supply chains and influence and to exercise pressure on the Western leverage in key geostrategic regions (Raphael ZiroMwatela, 2016).

The African government have not been passive consumers, in Ethiopia Chinese finance were used to reduce transit vulnerability in the project of Abba Djibouti Railway and to gain a

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<sup>57</sup> United Nations Educational, Scientific and Cultural Organization

regional center, and in Egypt the Suez Economic and Trade corporation is used as an opportunity for providing employment and export modernization (Breuer, 2017). In the areas where the discussion on debt and sovereignty continues numerous regions are using BRI involvement to have foreign partners other than the Western lenders highlighting that the initiative manage the geopolitical instrument in China and bargaining tool of African capitals (Raphael ZiroMwatela, 2016)

## Conclusion:

This paper has explored the economic and geopolitical drivers of investment in emerging markets with the focus on the progress of foreign direct investment, portfolio flows and public private partnership. The analysis is done using both theoretical views and empirical data made available by the international reports such as IMF, UNCTAD and World Bank. The study incorporates both the economic and political aspect and combining them to give a view of the role of investment flows in not only triggering developing countries but also transforming geopolitical alignments.

The results indicate the FDI is the most constant and dynamic type of investments usually related to the transfer of knowledge, the integration into the rest of the world in the long term and the modernization of industries. Portfolio flows were found to be volatile and procyclical often enhancing the financial instabilities in the foreign economies. The PPPs are another model of infrastructure financing although their effectiveness is extremely conditional on transparent governance and the proper division of risks.

The case study of China BRI in Africa present that economic factors are not always driven by investments.

Infrastructure development funded through the BRI, emphasize a dual justification, first to fill Africa infrastructure gaps and second to consolidate China geopolitical power and resources access. This example highlights a bigger conclusion of the thesis according to which the investment in EMs is determined by the economic factors and by the geopolitical calculations at the same time. The verification indicates that the development of the performance of this investment is skewed and, in the setting where institutions are strong and the policy frameworks are effective the FDI can drive growth and stability. In this context the governance structures are weak and the flows of investment can enhance fiscal vulnerability, dependency or countries being vulnerable to external shocks.

The findings of the thesis are applicable to policymakers, investors and international organizations. To make sure that the maximum benefits of the foreign investment, policymakers in EMs should be to enhance the quality of institutions, expand sources of financing to benefit from foreign investment. Investors must note that political stability and systems are as important as economic fundamentals in determining the returns. The

international organizations are able to contribute to establishing transparency and sustainability financing standards to decrease the risks of debt distress.

Future studies may move this analysis to compare regional case studies, or to understand how various EMs balance between the economic and geopolitical pressures or to understand how EMs are becoming outward investors themselves. This would enhance the knowledge on the changing position of emerging economies in the global financial and political system.

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