A STUDY OF CHINESE CAPITAL FLOWS TO SIX COUNTRIES

Mitigating Governance Risks From Investment in Southeast Asia

CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE

JANUARY 2020
# Table of Contents

Introduction .................................................................................................................. 2

Chapter 1
Chinese Investment in Southeast Asia: Making Sense of the Data ......................... 4

Chapter 2
Restoring Trust in the Belt and Road Initiative:
The State of Chinese Investment in Malaysia ......................................................... 10

Chapter 3
Chinese Foreign Direct Investment in the Philippines:
An Examination of Online Gambling and Energy .................................................... 13

Chapter 4
Chinese Investments in Cambodia:
Minding the Governance & Economic Gaps ......................................................... 16

Chapter 5
China’s Investment in Vietnam: Opportunities and Challenges .......................... 19

Chapter 6
Reaping Benefits While Mitigating Risks:
Myanmar’s Experience with Chinese Investment ..................................................... 22

Chapter 7
China’s Investment in Indonesia: Lessons from the Nickel Industry .................... 25

Chapter 8
Chinese Investments in Indonesia’s Financial Technology Sector:
The Case of Payday Loans ..................................................................................... 28

Conclusion .................................................................................................................. 32
Economic development and growth are fueling outbound capital flows from the People’s Republic of China (PRC) to global destinations. One region in particular has become a prominent recipient of Chinese capital: Southeast Asia. Geographic proximity, economic complementarity and China’s Belt and Road Initiative (BRI) are factors that have led to high levels of foreign direct investment (FDI) and other investments—such as development aid—flowing from China to numerous Southeast Asian states.

Emerging economies typically strive to attract FDI to stimulate economic growth. Yet while FDI does bring benefits to recipient countries, it can also expose weaknesses in procurement and governance practices, foster corruption and rent-seeking behavior, and cause environmental degradation. The chapters in this report summarize lengthier papers authored by experts based in Southeast Asian states, and reveal some common themes across a diverse swath of industries and countries to which Chinese capital has flowed.

All countries covered in this report have found that Chinese FDI and other investments can expose shortcomings in governance pertaining to procurement, the management of public-private partnerships, and labor and environmental regulations. While nations such as Malaysia and Indonesia can benefit from Chinese-funded infrastructure projects, their weak regulations and less-than-honest officials encouraged opacity and corruption. Such misconduct was put on display most famously in Malaysia’s East Coast Rail Link project, whose cost was allegedly inflated to shield former Prime Minister Najib Razak’s corruption scandal associated with the 1Malaysia Development Berhad, or 1MDB.
Most countries in this study also suffered negative environmental and labor market consequences as a result of Chinese capital inflows. While Chinese contractors and funders are often to blame, weak or poorly enforced environmental, labor and immigration regulations in countries such as Indonesia, Vietnam, the Philippines and Myanmar are also causes. Finally, governments in nations such as Cambodia and the Philippines have at times actively courted Chinese investment, or weakened existing constraints on capital inflows, leading to negative consequences for the local economy.

The encouraging news is that non-governmental organizations, civil society and government agencies in many Southeast Asian countries have demonstrated resilience, and have been working to blunt the deleterious effects of Chinese capital inflows. Myanmar has implemented a mechanism to increase the transparency of public-private partnerships, and Indonesia has worked to push legislation to enhance data privacy.

Each chapter’s author(s) have proposed recommendations tailored to local conditions to help maximize the benefits of Chinese and foreign capital inflows while minimizing risks. These recommendations range from centralizing national oversight of foreign investment, to establishing new environmental standards.1

1 Unless otherwise noted, all currency figures provided in US dollars.
CHAPTER 1

CHINESE INVESTMENT IN SOUTHEAST ASIA: MAKING SENSE OF THE DATA

Overview

The dramatic increase in capital flows from the People’s Republic of China (PRC) to countries throughout Southeast Asia brings both benefits and challenges to recipient countries. While the subsequent chapters of this study assess the impact of these PRC capital flows, this chapter clarifies some of the challenges stemming from defining and measuring them. It first defines the various types of capital flows, then summarizes official and unofficial (transactions-based) data for PRC foreign direct investment in eight Southeast Asian states: Cambodia, Indonesia, Laos, Myanmar, the Philippines, Malaysia, Thailand, and Vietnam. The chapter follows with a description of Chinese development loans and foreign aid in the region.

Defining Cross-Border Capital Flows

Cross-border capital flows are measured according to a country’s national accounting statistics. To distinguish between different types of capital flows, economists and statisticians separate such flows into five categories: direct investment; portfolio investment; derivatives; other investment; reserves. While flows in all five categories comprise PRC activity in Southeast Asia, this chapter focuses on the two most significant categories: “direct investment,” frequently cited as foreign direct investment (FDI), and “other investment.” FDI and development flows (a type of other investment) contribute both the largest volume and most politically significant types of flows.¹

¹ FDI involves foreign investors directly taking ownership of local assets, thus exerting influence over the operations of companies in the local economy, and influencing the social and economic welfare of local residents. Other investments include PRC development loans and aid, and flows have been growing apace to the region.
Chinese FDI in Southeast Asia

CHALLENGES OF MEASURING CHINESE FDI IN SOUTHEAST ASIA

Measuring Chinese FDI in Southeast Asia is more complicated than it might initially appear. Given different statistical methods and variations in capabilities across countries, FDI figures released by China and the recipient country frequently do not align. Capital controls in the PRC incentivize Chinese firms to misreport (and typically underreport) outflows.

Several other challenges muddy the clarity of FDI data. The use of holding companies and offshore vehicles to channel direct investments allows substantial flows to escape counting in official statistics. Although FDI data should, by definition, be recorded in market value, the difficulty of arriving at such a valuation means that official data often consists of book or historical value, leading to measurement errors. And, while FDI covers all investments with a 10% or higher share in voting rights, challenges in assessing this threshold complicate matters. As a result, international FDI statistics are usually published with a delay of 18 months or more, and are of mixed reliability.

In order to arrive at a more holistic and timely assessment of FDI flows, the authors of this and subsequent country case studies utilize three data sources to work around existing gaps and distortions to arrive at a more nuanced and balanced estimate of PRC FDI flows to Southeast Asian economies. The three datasets are:

- Association of Southeast Asian Nations (ASEAN) Statistics Division (ASEANstats). The ASEAN Secretariat publishes data based on the System of National Accounts, an international standard. ASEANstats provides data related to macroeconomics, FDI flows, and other key indicators;

- PRC Ministry of Commerce (MOFCOM). MOFCOM is the primary agency governing trade and FDI relationships, and publishes data on non-financial FDI. Non-financial FDI denotes direct investment by companies other than banking, securities, insurance, and other financial institutions. The State Administration on Foreign Exchange (SAFE) collects financial FDI, which is then combined with non-financial FDI into one statistical yearbook published by MOFCOM;

- Rhodium Group dataset on transactions data. Unlike the ASEAN and MOFCOM datasets, transactions data are not compiled using traditional balance of payments methods. Instead, these alternative datasets rely on publicly available data on mergers and
Employing all three datasets, the authors make several observations:

FDI contributes the largest volume of flows compared to the other four channels of PRC capital flows to the region. Chinese FDI into Southeast Asia has grown rapidly since the mid-2000s. All three data sources show an increase of Chinese investment into Southeast Asia in the past decade. However, transactions data display greater volatility in flows than official PRC data. Notably, there was a dip in annual investment flows around 2012-2014—a phenomenon reflected in official data. A decline in the energy and materials sectors during those years explains some of this dip.

FDI has grown rapidly but other categories of flows are catching up: FDI is historically the most important type of Chinese presence in Southeast Asia but China’s outbound presence has become more diverse in the past five years. Lending and government aid have grown rapidly across the region, especially from policy banks and large state-owned commercial banks. Private Chinese investors have also rushed into Southeast Asia’s technology scene, increasing the share of venture capital and other private equity investment as part of total capital flows. Because FDI and venture capital flows often complement one another, analysts should consider both types of flows.

Variation across countries: transactions data show that Malaysia and Indonesia are the biggest recipients of Chinese FDI, followed by Thailand, Cambodia, and Laos. Vietnam, Myanmar and the Philippines received relatively lower levels of Chinese investment. Greenfield investment, where a Chinese parent company creates a subsidiary and builds its operations from the ground up, is the main driver of Chinese investment in top recipient countries. This is in contrast to Chinese investment in advanced economies, where the majority of investment comes from acquisitions.

Variation across industries: transactions data show that the industry distribution of Chinese direct investment in Southeast Asia is visibly concentrated in real estate and hospitality, transportation and infrastructure, basic materials and energy. This is different from the breakdowns in official data. While ASEANstats data also show real estate as the top sector, other top sectors from ASEANstats and MOFCOM are financial services and wholesale and retail.

Ownership of investment sources: Chinese investment in Southeast Asia predominantly
came from state-owned investors (78% of total 2000-2016). In comparison, in the U.S. and Europe, Chinese investment in the early 2000s was more dominated by state-owned companies. But in recent years the share of private investors rose sharply.

Omissions in official data: official and transactions datasets likely do not capture capital flows stemming from informal activity. One particular distortion in Chinese outbound FDI statistics is extensive “informal activity” through special purpose entities in offshore financial centers (such as Hong Kong) and other channels that allow investors to bypass official approval and capital control. This issue is likely amplified in Southeast Asia due to its geographic proximity to China and large ethnic Chinese population.

Finally, while the three datasets paint a generally consistent picture of rising Chinese FDI in Southeast Asia, the contours outlined by each dataset often differ from each other. Because different data sources vary significantly in definition and coverage, analysts must consider a variety of sources when evaluating Chinese FDI flows to various Southeast Asian economies.

“Other Investment” – Chinese Development Flows to Southeast Asia

Chinese development flows to Southeast Asia have undergone rapid growth in the past two decades, similar to that of other outbound Chinese capital. Unlike FDI, PRC development flows primarily take the form of loans, extended most often by state-affiliated banks or state-owned enterprises to local government agencies or state-linked businesses in the recipient country. In addition to the repayable nature of these flows, development flows are further distinguished from common FDI by their origin. Development finance generally originates from the official sector or entities directly linked to the official sector, and the related flows themselves are in some way tied to state policy.

As much of PRC development lending targets large-scale infrastructure projects that also entail the use of Chinese labor and technology, these flows have critical implications for national security, technical capacity, and infrastructure autonomy for recipient countries. Recent evidence linking PRC development assistance to poor outcomes and indebtedness in recipient nations underscores the need to accurately measure and assess such development flows to Southeast Asia.

China does not adhere to global standards in terminology or methodology regarding development assistance, complicating efforts to track development flows to Southeast Asia. Researchers at Aid Data, a research laboratory at the College of William and Mary,
have overcome some of these obstacles by aggregating data from years of records of PRC development projects. However, the data behind similar FDI figures lags because of the labor-intensive nature of its collection.

Employing Aid Data’s dataset, the authors observe the following trends regarding PRC development loans and foreign aid vis-à-vis Southeast Asia:

• Chinese official flows to Southeast Asia have followed a growth trend similar to those of Chinese FDI to the region, as well as Chinese official flows to the rest of the world. Between 2000 and 2012, China delivered $5 billion in official development assistance (ODA) and $28.6 billion in other official flows (OOF) to Southeast Asia. Cambodia was the primary recipient of ODA ($2.7 billion) over this 13-year period, well ahead of secondary recipient Myanmar ($760 million). Over the same period, Laos received the largest quantity of OOF ($11.3 billion), followed by Indonesia ($6.5 billion);²

• China’s approach to development finance (aid) is to tie aid, direct investment, and trade to achieve a “win-win” for both China and recipient countries.³ Most Chinese aid projects are implemented by the Ministry of Commerce, in coordination with the Ministries of Finance and Foreign Affairs. Little official data exist documenting the specific mechanisms of Chinese aid.

• A large portion of Chinese aid has consistently gone to infrastructure projects. Foreign state-owned enterprises are also common recipients of aid flows.

• In its public pronouncements on aid and foreign relations, China claims to adhere to the “Five Principles of Peaceful Co-existence” and the “Eight Principles of Aid.”⁴ Both through its espoused principles and in public statements, China has encouraged a perception that Chinese development loans avoid political conditions typical of development assistance from developed, western states and traditional multilateral donors. Indeed, China rarely uses the donor/aid terminology common in the

---

² The Organization for Economic Cooperation and Development (OECD) classifies international development flows into two classes: official development assistance (ODA), and other official flows (OOF). Development assistance provided by most Western countries typically meets OECD criteria to be classified as ODA. Flows that do not meet ODA criteria are classified as other official flows (OOF). While some Chinese foreign aid meets criteria to be classified as ODA, most are classified as OOF.

³ Win-win, a term frequently used by the PRC in development finance contexts, is often viewed with suspicion by recipient countries and the international community. Critics note that the “wins” are normally greater for the Chinese than recipient country side.

⁴ The Five Principles of Peaceful Co-Existence and Eight Principles of Aid were established by the PRC during the Cold War era, with the former outlining China’s relations with India, and the latter encompassing Chinese development assistance.
international community. Instead, China frequently refers to itself as a “partner” in overseas development projects. Since 2010, much of China’s foreign assistance has been conducted under a “South-South” cooperation initiative, a framework China continues to use today. The chapters to follow will take a more in-depth look at the figures from each individual country.
CHAPTER 2

RESTORING TRUST IN THE BELT AND ROAD INITIATIVE: THE STATE OF CHINESE INVESTMENT IN MALAYSIA

Since China’s 2013 launch of the Belt and Road Initiative (BRI), Chinese investment flows to Malaysia have significantly increased. While augmenting historically robust economic relations between China and Malaysia, the influx of foreign direct investment (FDI) has exacerbated weaknesses in Malaysia’s public procurement system, exposed the poor governance of Malaysia’s government-linked companies (GLCs), and fueled corruption and rent-seeking behavior among politicians. Chinese FDI flows have been distributed across a variety of industries, but investments in large-scale infrastructure projects have gained attention due to both their complexity and association with corruption. Yet while Chinese FDI has brought costs, it has also benefited the Malaysian economy.

Chinese Investment in Malaysia

Although China’s FDI to Malaysia has skyrocketed since 2013, its total investment stock in Malaysia lags far behind that of Japan or the European Union. Historically, PRC investment has centered on manufacturing. But since 2013, investment in the real estate and hospitality sectors has ballooned. Reflecting the BRI’s focus on infrastructure development, PRC FDI directed toward greenfield construction projects has also grown since 2013, bringing large numbers of Chinese contractors and laborers in tow.

While infrastructure development will help stimulate long-term economic growth, the large influx of capital has also highlighted weaknesses in Malaysia’s governance and procurement policies, and fueled corruption and controversy. Several of
these “mega-projects” stand out for both their size and notoriety and illustrate the negative outcomes that can arise when large inflows of capital collide with weak governance and procurement regimes. The corruption scandal associated with 1Malaysia Development Berhad (1MDB), which toppled former Prime Minister Najib Razak’s government, is the most prominent example. However, three other FDI projects offer lessons as well: the Malaysia China Kuantan Industrial Park (MCKIP); Forest City; and the East Coast Rail Link (ECRL).

**Challenges Stemming from Chinese FDI – Three Case Studies**

The MCKIP is an industrial park whose development is jointly owned by a Chinese investment vehicle (Guangxi Beibu Gulf International Port Group) and a Malaysian consortium (Kuantan Pahang Holding). From a financial angle, the involvement of government-linked companies (GLCs) in the Malaysian consortium meant that Malaysian taxpayers bear ultimate responsibility for the project’s finances. Under internationally accepted standards of transparency in procurement and project finance, details regarding loans and investment should have been made public. In the case of MCKIP, the lack of publicly available information regarding loan guarantees and financial statements of GLCs is troubling. Furthermore, the involvement of a Malaysian politician—the Chief Minister of Pahang—in one of the Malaysian partner organizations violates conflict-of-interest standards.

Forest City, another real estate development funded by Chinese FDI, involves the Johor state government. Specific allegations regarding the Forest City project have yet to be made, but various dimensions of this US $95.6 billion project are alarming from both financial and ethical standpoints. The fact that members of the Johor state government concurrently serve as directors of a GLC involved in the project violates basic conflict of interest laws, as the government members could be incentivized to enrich themselves at the expense of the public interest.

The largest BRI project in ASEAN, the ECRL, was estimated to cost US $16 billion. Linking Kuala Lumpur with eastern peninsular Malaysia, it is funded by the Export-Import Bank of China. However, the ECRL has been mired in controversy due not only to the non-transparent and dubious financial terms, but because of allegations that the costs were deliberately inflated in exchange for Chinese assistance in bailing out a troubled GLC investment fund, 1MDB. While the Mahathir government renegotiated the terms of the ECRL, concerns related to the project’s transparency and financial soundness
persist. For example, the ECRL still lacks a transparent and fair procurement process.

The MCKIP, Forest City and ECRL projects illustrate the challenges of managing large inflows of Chinese capital without strong governance and public procurement systems. In the MCKIP and Forest City cases, the influx of capital heightened conflicts of interest among Malaysian politicians who also have a financial stake in the GLCs involved in the developments. The ECRL’s connection with 1MDB illustrates corruption at the highest levels that contributed to the electoral defeat of the Najib government, and the investigation of former Prime Minister Najib.

Costs and Benefits of Chinese Investments

Chinese FDI in Malaysia has also garnered controversy over the extent to which large infrastructure projects help the local economy. PRC-funded infrastructure development projects often come with terms that require the use of Chinese contractors. That can leave local contractors on the sidelines. There have also been widespread allegations that the previous Najib government offered favorable terms to Chinese investors and contractors so that Najib himself could profit from the numerous infrastructure development projects. Taken together, the public’s negative view of Chinese investments and corruption in the Najib government led to the historic 2018 election results that ended 61 years of rule by the Barisan Nasional (BN) coalition.

Chinese investment has brought some benefits to the Malaysian economy. For example, Chinese FDI has helped to develop Malaysia’s photovoltaic cell (PV) industry, propelling it to become the world’s third-largest. Chinese FDI has also transformed Malaysia’s glass manufacturing sector, shifting the country from being a net importer of glass prior to 2016 to becoming a net exporter.

Policy Recommendations

To help restore trust in the Malaysian government’s ability to manage inflows of Chinese FDI and maximize the benefits while mitigating risks from the BRI, Kuala Lumpur should address weaknesses in public procurement and the governance of GLCs. The government should also increase transparency through freedom of information legislation that would empower the public to hold the government accountable. While prioritizing private sector-led investment from China, Malaysia should also ensure that investments support the development of the local industry.
Private and state-backed foreign direct investment (FDI) from China has helped to generate employment and contributed to the Philippines’ economy, but at a cost. In some areas, capital inflows have exposed governance gaps and had a corrosive effect on oversight. The online gambling and energy industries provide illustrative cases of how Chinese FDI has taken advantage of loopholes in government regulations, thereby escaping scrutiny.

Chinese Investment in the Philippines

Like many of its peers in Southeast Asia, the Philippines encourages FDI from any source. While lagging behind other middle-income states, the Philippines still attracts a substantial amount of FDI due to its young, English-literate labor force. In the 2005-2016 period, China (including Hong Kong) was the third-largest source of FDI in the Philippines (Central Bank of Philippines, 2018).

The Philippines’ highly decentralized system of managing FDI is partially responsible for the negative externalities stemming from foreign investment, and has contributed to the proliferation of online gambling companies based in the Philippines. Since the start of the Rodrigo Duterte administration in 2016, the Philippines became an attractive destination for Chinese online gambling investments. This happened because of changes the Duterte government made to the Philippine Amusement and Gaming Corporation (PAGCOR’s) authority, cheap real estate, and a booming service sector. China’s state-owned enterprises (SOEs), such as State Grid Corporation of China, have also been active investors in the Philippines since Duterte assumed power.
Governance Challenges & Gaps Exposed by Chinese FDI – Online Gambling & Energy

THE PROBLEM WITH PAGCOR

The flood of Chinese investments into the Philippines’ online gambling sector has exposed weaknesses in the government’s regulatory regime, and opened the door to possible money laundering and illegal immigration. Lobbying by Philippine online gambling companies that supported Duterte in the 2016 election led to PAGCOR’s enhanced role as regulator, market participant and revenue collector vis-à-vis the online gambling industry. Foreign investors with opaque financial backing exploited the regulatory loopholes and conflicts of interest created by PAGCOR’s post-2016 powers, reinforcing any possible corrosive effects stemming from secret and opaque capital flows from China.

Special provisions in Philippine law empower PAGCOR to bypass other agencies when it comes to regulatory checks, revenue generation, and state capacity. This undermines multiple state agencies in their attempts to properly conduct due diligence regarding foreign investment in the gaming industry. Precisely because PAGCOR’s regulatory and revenue generation powers undermine the Bureau of Internal Revenue (BIR), the Philippines’ tax collection agency, it is difficult to guard against tax evasion as online gambling firms need only to report earnings with minimal documentation. The result is a system lacking in transparency and democratic accountability.

POWER GENERATION AND THE STATE GRID CORPORATION OF CHINA (SGCC)

President Gloria Arroyo’s 2001 privatization of the National Transmission Corporation, the Philippines’ electricity grid and network provider, resulted in the State Grid Corporation of China winning a 40% share in the consortium. As it is China’s state-owned utility monopoly and the largest utility company in the world, some Filipino politicians were concerned this gave Beijing the ability to access the Philippines’ power grids. Under President Benigno Aquino, the Department of Energy (DOE) tightened security on the SGCC and turned over the control of key operations to Filipino staff. However, President Duterte removed DOE’s protocols on SGCC activities, and has expanded SGCC’s presence in the country. For example, the Philippine government awarded SGCC the contract to expand telecommunications coverage using Huawei equipment.

Recommendations & Conclusions

Chinese FDI in online gambling has revealed weaknesses in, and corroded the integrity
of, Filipino institutions. Although increasing amounts of Chinese FDI have likely supported economic growth in the Philippines, Filipinos have also been negatively affected by economic and societal externalities, such as PAGCOR’s conflicts of interest, an influx of illegal workers, and the rise of real estate prices. Increases in the amounts of Chinese FDI, and the expanding footprint of Chinese state-owned enterprises, are hallmarks of the Duterte administration.

The solution to ending the corrosive effects of capital is not to forbid it. Rather, officials can take the following steps to reap the benefits of Chinese and other sources of foreign capital, while mitigating downside risks.

Concerning the online gambling industry, the government should:

• Address PAGCOR’s lack of accountability with other regulatory agencies, and PAGCOR’s internal conflict of interest. PAGCOR’s dual role as both regulator and market participant should be eliminated.

• Repeal PAGCOR’s power to directly issue gambling licenses without due diligence or pre-screening by the Bureau of Investment (BOI) or other Investment Promotion Agencies (IPA).

• Require online gambling operators to register with the BIR prior to issuance of a license. This would facilitate the collection of business taxes, and the withholding of employees’ taxes.

• Require online gambling operators to register their employees with the Bureau of Immigration (BI) to prevent black market and opaque organizations that launder money from bypassing immigration controls.

• Increase the budget of the BI to enhance risk management and enforcement capabilities, and prevent the bribery of BI officials.

Concerning risks to the Philippines’ infrastructure security, the government should:

• Create a centralized FDI-registration system, following the example of the Committee on Foreign Investment in the United States (CFUIS), or Indonesia’s Badan Koordinasi Penanaman. The Philippines’ current decentralized system allows investors to cherry-pick regulatory agencies, find loopholes, and escape transparency efforts.

• Encourage other foreign entities to invest in Philippine energy grids in order to dilute SGCC’s stake.

• Relevant agencies should work with outside experts to inspect and conduct independent audits of SGCC’s grids.
CHAPTER 4

CHINESE INVESTMENTS IN CAMBODIA: MINDING THE GOVERNANCE & ECONOMIC GAPS

Of all nations in Southeast Asia, Cambodia maintains the closest and friendliest ties with the People’s Republic of China. Sandwiched between historic rivals Thailand and Vietnam, and subject to sanctions and reproach by the U.S. and other western nations, Cambodia’s leaders have cultivated ties with China as a means of survival. The strength of bilateral relations is reflected in the fact that Beijing is Phnom Penh’s top foreign investor.

Chinese Investment in Cambodia

Robust levels of Chinese FDI in Cambodia rest on a foundation of deep political and economic ties between Phnom Penh and Beijing. Annual investment flows from China increased from $985 million in 2016 to $3.59 billion in 2018. The leading investment sectors included transportation, utilities, infrastructure, real estate, and energy. Chinese FDI has played an outsized role in Cambodia’s hydropower industry, with Chinese state-owned or government-linked companies responsible for producing an estimated 80% of electricity in Cambodia.

Cambodia’s open and liberal investment regime makes the country an attractive destination for FDI. For example, the government established the Cambodian Special Economic Zone Board (CSEZB) in 2005 to promote the establishment of Special Economic Zones (SEZ) and foreign investment. Furthermore, China’s Belt

---

1 Ministry of Commerce and Council of Ministers of Cambodia

and Road Initiative (BRI) and the Lancang-Mekong Cooperation schemes have been key drivers of Chinese capital flows. Chinese FDI has fueled Cambodia’s remarkable growth rate, averaging 7.7% annually over the past two decades.

Challenges with Chinese Investment

The large influx of Chinese FDI has exposed weaknesses in Cambodia’s institutional and regulatory capacity, eroding public trust in government institutions, fostering environmental degradation, and engendering negative public perceptions of Chinese capital. Ironically, a factor that has helped Cambodia to attract Chinese investment—the role played by ethnic Chinese—has also contributed to anti-Chinese sentiments. This is due to the fact that many projects built with the cooperation of ethnic Chinese tycoons, as well as Cambodian political leaders, have been detrimental to the environment. Large projects, such as hydropower plants, enjoy political protection from the Cambodian government, while they garner criticism for their lack of transparency and accountability.

Chinese investment has also been associated with land disputes and forced evictions. According to the local NGO Coalition of Cambodian Farmer Community (CCFC), some 20,000 families have suffered as a result of land disputes related to Chinese investment since 2003 (Reaksmey, 2018). Given loopholes in Cambodia’s land laws, as well as challenges with implementation and law enforcement, authorities have struggled to address these problems.

Deficiencies in Cambodia’s labor regulations, and their enforcement, have caused some Chinese-funded investment projects to serve as breeding grounds for crime. An influx of Chinese migrant workers, not all of whom are legal, has accompanied Chinese investment in Cambodia. Chinese FDI has also increased crime, fostered booming gambling and sex industries, and led to social and cultural tensions between the Chinese and local communities (Sovinda, 2019).

The Sihanoukville SEZ is a signature project under the BRI, and illustrates many downsides of Chinese-funded projects. Constructed by Chinese and Cambodian companies, the zone currently houses 161 companies with a labor force of approximately 22,500 (Hong, 2019). While the SEZ aimed to create a trading platform for export-oriented industries, the negative impacts on the local community and environment outweigh the benefits arising from the influx of Chinese investment.

One challenge with the Sihanoukville SEZ is that Chinese investments have not benefitted local businesses. As Chinese nationals own
more than 90% of businesses in the SEZ, local firms have had challenges partnering with SEZ firms, and have not been the beneficiaries of any technology transfers. One analyst argues that “unchecked development by Chinese investors has come at a cost, freezing out locals and changing the city’s character.” In contrast, large, more politically connected Cambodian corporations appreciate the opportunities to partner with Chinese companies.

Cambodia’s Strategic Outlook & Chinese FDI

Cambodia has nurtured close political and economic ties with China to strengthen its own economy and counter pressures from the U.S. and its allies on human rights issues. Cambodian elites—politicians and business tycoons alike—are the ones actively cultivating, and benefitting from, Chinese investment. Cambodia’s Under-Secretary of State of the Ministry of Economy and Finance encapsulated the dominant, elite view of Chinese FDI when he wrote: “the prospect of shifting and relocating some of China’s industries and production base to countries along the Belt and Road can only be promising for small economies like Cambodia” (Vanndy, 2019).

Yet, some of these same elites are also aware of the dangers of becoming overreliant on China. The tight links between Beijing and Phnom Penh also raise concerns that China plans to establish a naval base in Cambodia’s Koh Kong province. Moving forward, Cambodians will need to carefully balance the costs and benefits of their close economic and political linkages with China.

---

CHAPTER 5

CHINA’S INVESTMENT IN VIETNAM: OPPORTUNITIES AND CHALLENGES

In navigating a complex and multifaceted relationship with China, Vietnam has welcomed both foreign direct investment and development assistance from its northern neighbor.

Chinese Investment Flows

As part of its strategy to stimulate growth and deepen economic integration with the rest of the world, Vietnam has steadily enhanced its laws and regulatory regime to burnish its reputation as an attractive destination for foreign direct investment (FDI). For example, Vietnam’s 2014 Investment Law aligned the country’s regulations with the requirements of regional free trade agreements (FTAs), including the Trans-Pacific Partnership. Yet while Vietnam has been remarkably successful at attracting FDI, China’s share is small. In terms of total registered capital in 2018, China’s $33.2 billion pales in comparison to the $62.6 billion of Korea or the $57.0 billion of Japan.

Chinese investment in Vietnam also includes development assistance and other official flows (OOF), both classified as “other investments” under national accounting systems. Since the dawn of the Belt and Road Initiative (BRI), development loans from China have increased significantly, and have been directed toward construction of large infrastructure and power generation projects. Under the mechanism of engineering, procurement, construction (EPC) contracts, Vietnam regularly borrows from the Export-Import Bank of China, other state-owned Chinese banks, as well as traditional multilateral development banks such as the World Bank.
Challenges Stemming from Chinese Investment & Development Finance in Vietnam

Investments from China helped to bolster Vietnam’s infrastructure, but have also come with negative consequences. Some of these negative externalities—such as construction delays and environmental pollution—are certainly not unique to Chinese-funded projects; they afflict Korean- and Japanese-invested ones as well. Yet the scale of Chinese development loans means Chinese capital plays an outsized role in exposing weaknesses in Vietnam’s project management and governance capacities, and in generating controversy.

Chinese government funding of Vietnam’s energy sector, particularly coal-fired power plants (CFPPs), provides a window into the challenges stemming from Chinese development finance. With 80% of EPC energy sector contracts involving Chinese financing, funds from Beijing have featured prominently. The high share of Chinese-funded EPC contracts reveals a weakness in Vietnam’s procurement regime, which advantages low priced bids over quality and total life-cycle costs.¹ Bids from Chinese contractors are also problematic in that they tend to force Vietnamese authorities to purchase associated goods and services from China, a practice known as tied aid. Tied aid diminishes the benefits of development finance to local Vietnamese producers and suppliers.

Coal-fired power plants constructed with Chinese financing and by Chinese contractors also reveal gaps in Vietnam’s environmental regulations. Of the 36 CFPPs constructed under EPC contracts and examined by the authors, 19 plants were constructed by Chinese contractors. Fourteen of these plants have been involved in environmental incidents relating to dust pollution, slag disposal, and processing of industrial wastewater.

The Vinh Tan 2 Thermal Power Plant, a CFPP constructed by the Shanghai Electric Company, serves as a representative case. After the plant went into operation in 2014, it was involved in several environmental incidents and violations. The plant was fined $62,000 by the General Department of Environment. It was late paying the fine and took no further action to minimize pollution. The plant’s intransigence led to public demonstrations in 2015, when protestors obstructed adjacent highways to prevent the continued transportation of plant waste. The demonstrations quickly

¹ Chinese contractors tend to offer the lowest bids due to government subsidies from Beijing.
escalated, and many people threw stones and gasoline bombs. Also driving public anger were reports that the plant imported large numbers of Chinese laborers.

The problem of environmental violations is also shared by Vietnam’s own system of regulations, planning, and enforcement. For example, the lack of sufficient slag disposal sites and the absence of technical standards for the disposal of slag gives plants more leeway to pollute.

**Recommendations**

To increase the effectiveness and benefits of Chinese FDI and development assistance, the authors recommend the following:

To improve the terms and conditions associated with foreign capital flows, the government should:

- Apply multilateral development bank (MDB) standards to BRI loan projects.
- Adapt and expand the 2005 Hanoi Core Statement on Aid Effectiveness to include indicators and targets for untying aid.
- Move from Low-Bid Procurement to Life-Cycle Cost Analysis (LCCA) to promote a quality infrastructure approach.

To improve transparency, the government should:

- Report large-scale and key projects to the National Assembly or State Council.
- Utilize dialogue channels, including scholars and public figures, to publicize objective statements about project development.
- Solicit and encourage non-governmental organization (NGO) participation to hold investors and construction parties accountable.
- Publish clear regulations related to the participation of private enterprises in projects, and disclose participation by those in government to limit conflicts of interest.

To protect the environment, the government should:

- Enforce and update existing environmental and social protections.
- Defend and strengthen the capacity of environmental and social ministries to enforce and upgrade laws.
- Spearhead collaboration between the government, civil society, and foreign investors to achieve informed consultation before projects begin.
CHAPTER 6

REAPING BENEFITS WHILE MITIGATING RISKS: MYANMAR’S EXPERIENCE WITH CHINESE INVESTMENT

As an emerging economy, Myanmar requires significant inflows of capital to develop its infrastructure and improve the lives of its people. However, the influx of investment has come with some negative consequences, exposing governance gaps and the weak capacity of Myanmar’s institutions to absorb such levels of unregulated capital. Myanmar’s government has taken steps to improve the oversight of Chinese foreign direct investment (FDI) supported projects, but will need to do more in the coming years as Chinese FDI will likely increase under the Belt and Road Initiative (BRI) and China Myanmar Economic Corridor (CMEC).

Chinese Investment in Myanmar

Foreign direct investment flows from China have played an important role in Myanmar’s economic and political evolution for many years. Since 1988, and particularly after the 2007 Saffron Revolution, international sanctions isolated the ruling military government. That forced it to increase reliance on China for military, diplomatic, and economic support. Between 2004 and 2011, Chinese investment in Myanmar surged, with most of the growth occurring after 2007. Total investment grew from $20.18 million in 2004, peaked at $1.52 billion in 2011, and then declined as the previous Thein Sein government began political reforms that led to an easing of sanctions from the West.

The Chinese government’s cultivation of relations with the then opposition party, the National League for Democracy (NLD), aided Chinese business interests. After the NLD won a landslide victory in the 2015 election, Chinese investments gradually increased
Corrosive Effects of Chinese FDI on Governance

The surge of Chinese investment in Myanmar has proved controversial. It is straining Myanmar’s already weak governance capacities and stoking public opposition. Prior to 2010, Chinese investment tended to be concentrated in extractive industries, such as mining and hydropower. Of these, the Myitsone Dam attracted the greatest public criticism for its opaque financial terms and potential for environmental damage. Popular backlash forced the Thein Sein government to suspend the dam’s construction in 2011, and also redirected Chinese investors to focus on other infrastructure projects.

Yet despite the shift to infrastructure development from extractive industries, Chinese FDI continued to nurture corruption and elicit negative perceptions among ordinary Myanmar residents. While Myanmar sorely needed foreign capital for infrastructure development, the country’s governance and public-private partnership (PPP) management abilities were too immature to deal with Chinese state-owned enterprises (SOEs) and corrupt partners. Incomplete ownership laws allowed individuals to hold secret equity positions in public enterprises, leading to conflicts of interest. Weak enforcement of environmental, procurement, labor, and immigration laws meant that Chinese FDI often benefitted only those with connections. Several examples illustrate collusion among PRC SOEs and Myanmar military oligarchs.

After Myanmar’s former military rulers signed ceasefire agreements with ethnic armed groups in northeastern Myanmar, Chinese investors engaged in “ceasefire capitalism,” taking advantage of post-chaos conflict, a porous border with China, plentiful natural resources, and former rebels who were looking to make a profit. For example, in the Letpadaung mining project, the Chinese SOE China North Industries Corporation (NORINCO) formed a joint venture with military-owned Myanmar Economic Holdings Limited (MEHL) through its subsidiary Wanbao Mining (GEI, 2016). Similarly, the Asia World Company, which is owned by the son of former drug lord Lao Hsiang Han, holds a 5% stake in the Myitsone Dam project and is a local partner in many other hydropower projects (Tha, 2019).

---

1 ASEAN Secretariat, ASEAN Statistical Yearbook, December 2018.
Because these deals were not subject to open tender and were conducted under a cloud of opacity, they aggravated local grievances over environmental damage, land confiscation, and forced relocation, especially of ethnic minority groups. The large presence of Chinese laborers also fed the perception that Chinese FDI was not benefiting the local economy. Myanmar’s private sector has welcomed Chinese FDI, but some manufacturing companies have expressed concerns that Chinese companies—heavily subsidized by the state—have hollowed out domestic manufacturers.

Although the Project Bank mechanism is an excellent start, the Myanmar government can take additional steps to ensure that Chinese FDI is used most efficiently and for the benefit of the public at large. Before projects begin, the government should conduct transparent land, social, and environmental assessments. This would raise public awareness of projects, clarify land acquisition procedures, guarantee the protection of the livelihoods of local people, and put in place measures to prevent environmental degradation due to construction.

Steps Myanmar Has Taken to Address Governance Gaps & Recommendations

The Myanmar Office of the President’s Project Bank Notification 2/2018, which laid a regulatory framework leading to the creation of an online database that launched in early 2020, established guidelines and procedures for developing projects in accordance with strategies and action plans in the Myanmar Sustainable Development Plan (MSDP). Chinese investment should increase in the coming years under the CMEC framework. The Project Bank provides the regulatory framework and transparent mechanism that will reduce the likelihood of corruption and collusion in Chinese funded infrastructure development projects and PPPs.

To increase transparency, the PPP Center or the Ministry of Planning and Finance should issue regular press briefings and host project information sessions in order to increase public participation, address misinformation, and ensure that the projects are being planned and implemented following national laws and regulations. Furthermore, mandatory price analysis by an expert third party on all large-scale public works projects funded from abroad will ensure transparency in investments, business acquisitions, and agreements. Finally, the government must enforce Project Bank policies and regulations.

Taken together, the above steps would help ensure that Myanmar is open for business while establishing risk mitigation strategies that allow its citizens to reap the benefits of foreign investment.
CHAPTER 7

CHINA’S INVESTMENT IN INDONESIA: LESSONS FROM THE NICKEL INDUSTRY

Enhanced diplomatic ties between Indonesia and China in the past decade have brought ballooning amounts of foreign direct investment (FDI) from Beijing to Jakarta. While Chinese FDI has enhanced Indonesia’s economy, it has also come with unintended consequences. Through numerous interviews with government officials, analysts and business stakeholders, the authors examined Chinese FDI in Indonesia’s nickel mining sector, and provide insights regarding the costs and benefits of Chinese capital inflows.

Chinese Investment in Indonesia

Foreign direct investment flows from China feature prominently in Southeast Asia’s largest nation—Indonesia. Robust economic relations between Jakarta and Beijing have been nurtured by leaders of both countries over the years. In 2005, Indonesian President Susilo Bambang Yudhoyono and Chinese President Hu Jintao declared bilateral ties as a “strategic partnership.” When Chinese President Xi Jinping visited Indonesia on his first foreign trip in 2013, bilateral ties were upgraded to a “comprehensive strategic partnership.” More recently, Indonesian President Joko Widodo elevated relations with China as part of Beijing’s Belt and Road Initiative (BRI).

As part of enhanced bilateral ties, Chinese FDI in Indonesia grew from $300 million in 2012 to $3.36 billion in 2017, making China the third-largest foreign investor in Indonesia, up from the twelfth largest just five years prior. Much of Chinese FDI has

been concentrated in the minerals and mining sectors, driven heavily by China’s demand for nickel, and its plentiful supply in Indonesia.\textsuperscript{2} Given the importance of the mining sector to Indonesia’s economy—they contributed more than 4% and 12% to Indonesia’s GDP and exports, respectively, in 2017—China’s increasing investments in the country’s mining sector brings both economic and political benefits and risks.\textsuperscript{3}

\textbf{Chinese FDI in Indonesia’s Mining Sector – the Indonesia Morowali Industrial Park (IMIP)}

China’s appetite for commodities, such as nickel, dovetailed with Indonesia’s desire to develop its mining and smelting industry across a variety of minerals and metals. With the facilitation and approval of Jakarta’s Ministry of Industry, the IMIP, in Morowali Regency, Central Sulawesi Province (which is nickel-rich), was completed in only five years. IMIP is owned by PT Sulawesi Mining Investment (a holding company) that is jointly invested and funded by Shanghai Decent Investment (a corporation of Tsingshan Steel), which holds 66.25% of the shares, and the Indonesian mining company Bintang Delapan Group—which holds the remaining 33.75%.

While IMIP is an impressive facility that employs 32,000 people, has ports capable of handling 100,000 tons deadweight, and boasts its own airport and hotel, it has not been immune to problems that have plagued other Chinese-funded developments. PT Sulawesi Mining Investment is alleged to have employed illegal workers from China, undercutting employment benefits to the local economy. There are also reports that IMIP has benefited from its relations with retired Indonesian army generals. Although the authors of this report have found no explicit reports of corruption, the fact that five investment transactions in IMIP totaling US $1.27 billion occurred within four years is surprising considering the number of environmental permits typically required, and the time it normally takes to secure them.

\textbf{Costs & Benefits of Chinese Investments}

From interviews with other nickel producers and businesses, the authors found that Chinese FDI in Indonesia’s mining sector is tied with China’s ambition to control

\textsuperscript{2} China’s demand for nickel ballooned in the last decade due to the development of the electric vehicle (EV) industry. EV batteries require nickel to manufacture. On the supply side, Indonesia has one of the largest laterite nickel deposits in the world.

\textsuperscript{3} The mining sector has been critical to Indonesia’s economic growth over several decades. Mining contributes to Indonesia’s gross domestic product (GDP) through exports, government revenue, worker salaries, and perhaps most importantly, through associated development projects in many remote regions of Indonesia. Mining companies are often the largest employers in these remote areas.
the global market. China’s competitive technology, business savvy, rapid project completion times and lower prices make Chinese investors the partners of choice. Yet while Chinese investors and contractors work with unmatched speed, they tend to ignore local laws. Also, Chinese bids are often low because of government subsidies from Beijing. Joint ventures that involve Chinese capital often require projects to only utilize Chinese technology, effectively shutting out many business opportunities for Indonesian vendors. Chinese investment in nickel and other smelting industries has also resulted in price-fixing, where the selling price of raw nickel ore is often 50% of the regulated market price. Indeed, the Indonesian Nickel Association has complained that miners often do not receive a fair profit, due to low purchase prices demanded by smelters. The Indonesian Corruption Eradication Commission has also warned the government and business communities that Chinese investors have failed to meet environmental and sustainability obligations.

Conclusions & Policy Recommendations

While Chinese capital has helped the Indonesian mining sector graduate from being just an exporter of raw materials to selling processed—and more valuable—products, such capital has also brought negative consequences. Projects funded with Chinese capital are often subject to violations of local labor and environmental regulations, corruption, and can depress the price of nickel. Indonesia’s mining sector is also illustrative of Chinese companies’ willingness to take greater risks and invest in regions abandoned by larger, western mining companies. In the absence of other investors and operators, there are fewer incentives for local officials to enforce environmental regulations.

To maximize the benefits of Chinese investment while mitigating its downside risks for Indonesia, the authors recommend:

- Improving the system of work permits and business licenses for foreign investors. With real-time, accurate data regarding the number of foreign workers involved in projects, authorities will be better able to identify illegal workers.
- Establishing a fair and transparent nickel trading system, and a Nickel Price Index. This would address the problem of price-fixing and decrease the likelihood of wild fluctuations in the nickel prices.
- Enhancing selection criteria in welcoming Chinese investment.
- Inviting more competitors to invest in nickel refinement.
CHAPTER 8

CHINESE INVESTMENTS IN INDONESIA’S FINANCIAL TECHNOLOGY SECTOR: THE CASE OF PAYDAY LOANS

Beijing contributes a significant amount of capital to Jakarta’s mining industry. However, as a reflection of the global technological revolution, Chinese companies have also invested heavily in financial technology, or fintech, sectors throughout Southeast Asia. Including diverse activities such as ridesharing, e-banking and large e-commerce platforms, the fintech sector is as broad as it is dynamic.

Indonesia presents a controversial case where regulatory gaps in data protection and privacy are compounded by predatory business practices. This has shed light on data governance, an often ignored topic in the region related to Chinese investment. In Indonesia, the predominance of Chinese-funded and controlled payday lending platforms has harmed poor and vulnerable Indonesian borrowers.

Chinese FDI in Indonesia’s Fintech Sector

The rise of smartphone use in Indonesia, combined with lags in penetration by traditional brick-and-mortar banks, has opened the door to more efficient financial products that do not rely on bank cards or branches. Fintech utilizes mobile technologies to provide an array of services, such as digital payments, online lending, credit scoring, and wealth management. Chinese capital, from well-known sources such as Alibaba, Tencent, and JD, have participated with other western investors such as Warburg Pincus, BlackRock, and Google, to invest in Southeast Asian firms that control numerous fintech-related businesses in Indonesia. Chinese companies have also partnered with local firms, or established subsidiaries, to establish fintech providers in Indonesia.
In the domain of fintech lending, Chinese-invested or Chinese-controlled firms dominate only in the payday lending sector. Approximately two-thirds of payday lending platforms are either Chinese-controlled (at 61%) or Chinese joint ventures (at 6%). These Chinese-linked platforms are among the top ten in terms of transaction volume and number of borrowers in Indonesia. Some notable ones include: Akulaku, founded by an independent Chinese entrepreneur, with substantial investments from Alipay’s Ant Financial; and Dana Rupiah, a subsidiary of China-based Weshare Group, offering payday loan products.

Challenges Stemming from Payday Lending Platforms

The proliferation of payday lending fintech apps/platforms has sparked a public outcry against their abusive and predatory practices, and exposed gaps in Indonesia’s regulatory environment surrounding financial services and technology. Regardless of the origin of their controlling stakeholders, the business model of payday lenders consists of exploiting the existing regulatory framework, which was not designed to govern payday loans. However, the dominance of Chinese-controlled firms in this sector feeds the popular perception that Chinese capital is to blame for payday lending’s woes.

Online payday platforms have given fintech a negative reputation in Indonesia because of their opaque, predatory, and abusive business practices. According to the Indonesian Legal Aid Foundation, fintech payday lenders charge ultra-high interest rates of 1% to 2% per day, hide fees and penalties, do not maintain good administrative and record-keeping systems, access personal data in customers’ mobile phones, use borrowers’ contact information to reach out to contacts without the borrowers’ consent, and threaten borrowers during the collection process (CNN, 2018).

These practices have not gone unnoticed by the public. From July through December 2018, a series of protests and mass rallies throughout cities in Indonesia targeted fintech payday lenders for their improper behavior. Most of these protests related to fintech payday lenders that were not registered with the Indonesian Financial Services Authority (OJK), but a few registered fintech payday lenders were also targets of the protests. Illustrating the gravity of the problem, Indonesian Consumer Watch (YLBHI), a non-governmental organization on consumer
affairs, has received more than 3,000 complaints about payday lenders as of February 2019 (Heriani, 2019).

The fintech payday lenders’ abuses occurred because Indonesian regulators have been unable to anticipate consumer needs and regulate the industry’s development. Fintech payday lenders have not been required to register with OJK, as unlicensed money lending is not a crime. In contrast to regulations governing banks, fintech lenders face no constraints on interest rates, pricing and information disclosure, or collection standards. The United Nations Conference on Trade and Development (UNCTAD) also noted that Indonesia’s consumer protection system needs to address e-commerce and data protection issues (UNCTAD 2019).

The government has been catching up, yet its lag feeds into the perception that payday lenders, especially Chinese ones, are bypassing, ignoring, or undermining Indonesian regulators.

In response to the protests and concerns regarding fintech payday lenders’ abuses, the OJK issued a decree in February 2019 restricting fintech lenders’ access to mobile internet data, with the exception of the smartphone’s microphone, location and camera. However, the Indonesian Fintech Lenders Association (AFPI) has demanded the right to access app histories and call logs, in part because of the difficulty of assessing credit risk without an adequate credit rating system.

Recommendations & Conclusions

Indonesian consumers have been able to enjoy the benefits coming from fintech innovation, but some sectors of the population have suffered at the hands of unscrupulous payday lenders. While the government and relevant agencies, such as OJK, have drafted new rules and implemented policy changes to mitigate the harmful effects of fintech payday lenders, there continue to be gaps that need plugging. The government should:

- Impose long term institutional reform, such as the development of a robust credit information institution. A credit monitoring institution will also be crucial for providing comprehensive data for loan decision making.
- Address the loophole concerning capital inflows from foreign peer-to-peer lending platforms. At present, foreign platforms can lend to Indonesian

---

2 However, it is a crime to accept deposits without a license.
fintech lenders, who in-turn lend to borrowers—a practice that allows foreign firms to lend without a license.

- Enhance protections for data. The government’s Draft Bill on Personal Data Protection (PDP), which did not pass in 2019, should be re-visited.

Fintech payday lenders use predatory tactics that have harmed vulnerable Indonesians in serious ways. While there was no evidence that the Chinese or foreign fintech operators have intentionally corroded democratic or governance systems in Indonesia, the regulatory gaps in the sector have led to misuse of consumer data and violations of privacy. This is a common issue across the region that will require more attention.
Investments from China into Southeast Asia have contributed to economic growth and the development of the private sector in the host countries. For example, in Malaysia, the solar panel and glass industries have seen leaps in growth due to Chinese investments. Yet there are also cases in Southeast Asia in which the local private sector received marginal benefit from Chinese investments. For instance, in Cambodia, the report showed that Chinese firms have little interaction with local firms and do not contribute much to the capacity and skill development of the local workforce. As a result, the spillover effect of Chinese investments on local SMEs has been limited.

Local firms in host countries seek to benefit more from investments from China. Several authors pointed out that small businesses are concerned about being unfairly outcompeted by Chinese firms, which are supported by state-led industrial policies and cheap credit from the state.

Foreign direct investment from China sometimes goes into high risk and lightly regulated industries, such as mining, online gambling, and payday lending. In the cases of the Philippines and Indonesia, the authors documented that these investments bypass, ignore, or undermine regulations in the host countries. Problems include importing illegal workers, evading taxes, and exploring military networks deeply vested in the economy. Southeast Asia’s young democracies have suffered from weak rule of law and lax enforcement. Chinese investments at times exploit and exacerbate these governance gaps.

Chinese-funded megaprojects raise more concerns than traditional FDI due to a lack
of transparency and the opacity of the
deal-making processes. The deals are made
among the ruling elites of China and the
host countries without proper scrutiny or
oversight. It is widely recognized that the
influx of Chinese capital and contractors
help to alleviate the massive infrastructure
gap in the region. To better utilize these
capital inflows, the governments in Southeast
Asia need to strengthen their capacity to
mitigate the risks identified in this report,
such as weak public procurement regulatory
regimes, a lack of information on and robust
oversight of BRI projects, weak governance
of SOEs, and corruption.

Table 1 below lists recommendations to help
mitigate risks stemming from large Chinese
investment inflows:

<table>
<thead>
<tr>
<th>PROBLEMS</th>
<th>SOLUTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of transparency in public</td>
<td>• Increase transparency of the public sector and public procurement process</td>
</tr>
<tr>
<td>procurement</td>
<td>• Have clear legal regulations on public procurement</td>
</tr>
<tr>
<td></td>
<td>• Follow public procurement international best practices, such as</td>
</tr>
<tr>
<td></td>
<td>competitive and public bidding</td>
</tr>
<tr>
<td></td>
<td>• Replace low-bid procurement practices with Life-Cycle Cost Analysis</td>
</tr>
<tr>
<td></td>
<td>(LCCA) to promote quality infrastructure project</td>
</tr>
<tr>
<td></td>
<td>• Empower civil society and interested stakeholders to advocate for greater</td>
</tr>
<tr>
<td></td>
<td>transparency on the public procurement process</td>
</tr>
<tr>
<td>Corruption</td>
<td>• Strengthen anti-corruption work through institutional changes</td>
</tr>
<tr>
<td></td>
<td>• Lawmakers should exercise oversight of loans that the government</td>
</tr>
<tr>
<td></td>
<td>undertakes</td>
</tr>
<tr>
<td></td>
<td>• Implement the Freedom of Information act</td>
</tr>
<tr>
<td></td>
<td>• Publicize government loan terms</td>
</tr>
<tr>
<td></td>
<td>• Disclose ownership of companies that participate in mega infrastructure</td>
</tr>
<tr>
<td></td>
<td>projects (especially if these companies are owned by government officials,</td>
</tr>
<tr>
<td></td>
<td>their families, or close associates).</td>
</tr>
<tr>
<td></td>
<td>• Provide for third party quality control/independent audit mechanism of</td>
</tr>
<tr>
<td></td>
<td>the mega infrastructure projects</td>
</tr>
<tr>
<td></td>
<td>• Implement PPP laws to facilitate investments and monitor PPP projects</td>
</tr>
<tr>
<td></td>
<td>to increase transparency and accountability</td>
</tr>
</tbody>
</table>

CONTINUES ON NEXT PAGE
The countries of Southeast Asia should strengthen their regulatory environment to reduce the likelihood of corruption, increase transparency, enhance oversight mechanisms, and improve their public procurement framework. In addition, civil society organizations can play a more significant role as a bridge between foreign investors and local communities to spearhead inclusive dialogue among governments, local civil society, and foreign investors before megaprojects begin to ensure that local voices are heard. Civil society and a free press can also help monitor foreign business behavior and promote OECD guidelines for multinational enterprises in agriculture supply chains, the extractive sector, mineral supply chains, and textile and garment supply chains to advocate for more responsible business practices.
Governments can also use regional platforms such as ASEAN to gain stronger negotiation power when advocating for more responsible investments from China.

For China

Chinese civil society is eager to work with foreign counterparts to encourage Chinese firms to engage in more corporate social responsibility and be more responsive to local communities’ concerns. Chinese companies could seek Chinese civil society’s assistance to try to act more responsibly and inclusively.

The Chinese government could work with Chinese companies abroad to ensure that they are abiding by guidelines released by Chinese business associations. The mining and construction industry associations from China have published guidelines that are on par with international standards. More broadly promoting and sharing these guidelines would help improve business behavior overseas.

Regarding investments with an international development purpose, China should try to employ the standards of the Asian Infrastructure Investment Bank (AIIB) in all its BRI projects to ensure that this new global power is also advancing development goals by acting more responsibly. Greater transparency in business engagements and MOUs between governments would help improve China’s image in the region and counter a reputation of colluding with ruling elites.

Lastly, the report highlights research questions requiring further scholarly attention, including:

- Whether Chinese private firms are driven purely by the profit motive or instead act based on the policy guidelines from the state
- Whether SOEs and private firms from China respond differently to local pressure and incentives
- The extent to which China uses its economic leverage to influence host countries’ domestic politics or foreign policy.
ACKNOWLEDGEMENTS

The report was authored by think tanks and researchers from Southeast Asia and was prepared by the Center for International Private Enterprise, an international affiliate of the U.S. Chamber of Commerce and a core institute of the National Endowment for Democracy (NED).

Primary Authors of Original Publication & Summary Chapters

Laurence Todd, Azam Wan Hashim, Septa Dinata, Muhamad Ikhsan, Mary Silaban, A. Khoirul Umam, Chheang Vannarith, Khine Win, Ajisatria Suleiman, Pingkan Audrine Kosijungan, Galuh Octania, Alvin Camba, Thilo Hanemann, Stanley Seiden & John Fei

Editors and Contributors

ABOUT CIPE

The Center for International Private Enterprise (CIPE) is a non-profit international affiliate of the United States Chamber of Commerce and a core institute of the National Endowment for Democracy. Founded in 1983, CIPE’s mission is to strengthen democracy around the globe through private enterprise and market-oriented reform, fulfilling our vision of a world where democracy delivers the freedom and opportunity for all to prosper. CIPE does this by partnering with local business associations, chambers of commerce, universities, think tanks, and advocacy groups to advance democratic and economic reforms worldwide.

CIPE is headquartered in Washington, D.C. and currently has regional offices and representatives in more than a dozen countries, as well as a vast network of partners past and present. A wide range of donors directly support CIPE’s work, and CIPE regularly collaborates with other international development and democracy organizations to carry out joint projects.