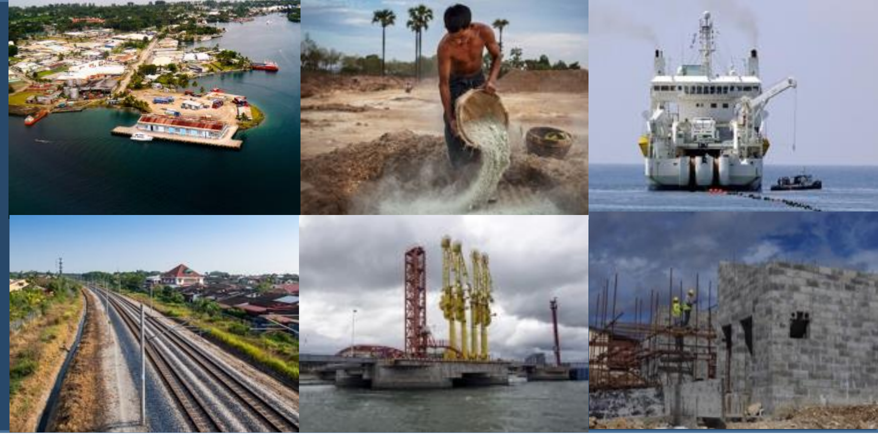
BRI MONITOR

POLICY BRIEF:
Trickle-Down Effects from BRI Projects to Local Economies



BRI Monitor is a joint initiative started by think tanks in Asia and the Pacific to track the impact of China's Belt and Road Initiative projects. A key aim is to promote transparency and governance of China's many massive and costly projects. Partners worked with the Center for International Private Enterprise to create standards for measuring and assessing project cycles.

TRICKLE-DOWN EFFECTS OF BRI?

Foreign direct investment (FDI) is vital to the economic growth and financial health of developing countries. It can be transformative because it triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps create a more competitive business environment and enhances enterprise development. Capital-intensive investments in much-needed infrastructure, particularly in the transportation and energy sectors, stimulate local and sustainable development and offer improved access to transit, energy, and technology, as well as new jobs. Some but not all of these various trickle-down effects can be negotiated into a contract to build things like bridges, wind farms, dams, or toll roads, but typically tend to materialize when those foreign investors lack political motivations, are willing to be accountable to local stakeholders and offer transparent funding options. These are the hallmarks of constructive capital.

However, the trickle-down effect of constructive capital depends on good governance practices by the host government, including accountability to citizens. Trickle-down economic benefits from FDI are even greater if there is host-country investment transparency, including investment screening, the implementation of access-to-information laws, publicly released project documents, openness to trade, and strong regulatory frameworks.

Without many or all of those conditions, FDI can become corrosive instead of constructive. Corrosive capital tends to concentrate economic benefits in the hands of the few, rather than distributing them to the general population through trickle-down effects such as hiring local subcontractors and workers.

China’s Belt and Road Initiative has offered funding for major infrastructure projects across the Global South. Unfortunately, these investments tend to have incredibly low trickle-down effects on local economies. Agreements between donor and host country are set up so that most of the spending remains within Chinese hands, reducing trickle-down effects. Recent scholarship shows that infrastructure projects funded by multilateral development banks make greater use of local contractors, and therefore offer larger trickle-down effects.

A report from the Center for Strategic and International Studies, a Washington-based think-tank, found that local companies comprised less than 12 percent of contractors working on China-funded transportation infrastructure projects in Asia and Europe, compared with 41 percent when multilateral funders set the rules. The study covered 178 projects from 2006 to 2018.

Evidence also shows that the completed BRI infrastructure projects do not always help the local private sector. Organizations like the European Chamber of Commerce in China have complained that Chinese-funded telecommunications networks have not benefitted the local private sector, instead making it difficult for European shipping companies, computer software providers, and other businesses to compete. A survey of the chamber’s members also demonstrated that they had been completely left out of bidding processes for BRI contracts.

The BRI Monitor initiative is a growing program to track and monitor Chinese projects in Southeast Asia and beyond. Partner organizations are currently analyzing publicly available information for 20 projects in Asia and the Pacific. Across Southeast Asia, projects meant to stimulate local economic growth have stalled, as is the case with the Gemas-Johor Bahru Electrified Double-Tracking Project in Malaysia. The project has had long delays; despite its revival in 2007, the project contract was not awarded until 2016, and land acquisition disputes have pushed its completion date to April 2026, according to a news article in the *Malay Mail*. The project also had one of the highest costs per kilometer of rail, and coupled with the long delays, it runs a high risk of potential cost overruns. In all BRI Monitor case studies lead contractors are Chinese firms, and most are state-owned enterprises, demonstrating the lack of benefits to local contractors and workers when these projects are enacted.

In the case of the Western Pacific University project, the lead contractor was a Chinese private firm, China Jiangsu International Economic and Technical Cooperation Group, which has been debarred by the World Bank since 2014 due to corruption allegations. This case demonstrates that BRI projects adopt preferential treatment to Chinese contractors even when they are violating international standards. Additionally, due to the inherent lack of transparency, specific losses of economic opportunity are difficult to quantify precisely, but indicators of corrosive capital in this project include the lack of involvement of the local regional government. BRI case study examples from the Philippines and Papua New Guinea illustrate how local contractors and workers can be side-stepped to the benefit of foreign donors.

PHILIPPINES

In all four BRI Monitor cases from the Philippines, laws that grant preference to qualified domestic contractors and required competitive procurement processes were not followed. The Government Procurement Reform Act (Republic Act No. 9184) dictates that competitive bidding is a basic government procurement principle, and the 1987 Constitution provides that preference be given to qualified Filipinos. However, this constitutional requirement does not apply to the procurement of goods, infrastructure projects, or consulting services funded by foreign grants, creating an opportunity for foreign contractors. Consequently, Chinese companies bidding for contracts seemingly did not have to compete with other potential contractors. In the case of the DITO Telecommunity project, only three companies bid for the contract to become the Philippines' third major telecommunications operator. Mislatel Consortium – now DITO – bid effectively unopposed after its competitors were disqualified by the government. For example, the Philippine Telegraph and Telephone Corporation (PT&T), a Philippine bidder, was disqualified for not operating nationwide despite regional operations spanning most of the country for over 50 years. DITO is owned by China Telecom Corporation and two Philippines-based companies founded by businessman Dennis Uy, who contributed 30 million Philippine peso ($539,222) to the Duterte presidential campaign. Several other Duterte campaign donors were linked to the Mislatel consortium, creating a conflict of interest.

Despite the legal loophole allowing foreign-funded projects to bypass preference for Filipino contractors, the law still requires a competitive bidding process for foreign-funded procurement. For the New Centennial Water Supply-Kaliwa Dam Project (NCWS-KDP), a flawed bidding process raised questions about its legitimacy. According to the Philippine Commission on Audit, the process was not truly open. Two of the three bidding contractors were included solely to give the "semblance of a competitive bidding when in reality, it is a negotiated contract from the inception of the bidding process." Both of the other bidders seemed to intentionally fail to comply with technical requirements and budget ceilings, the auditors wrote, and were disqualified in the early stages of the procurement process, according to the auditor's report.

PAPUA NEW GUINEA

In Papua New Guinea, all three Chinese-funded projects tracked by the BRI Monitor contracted with Chinese companies. PNG procurement regulations under the 2018 National Procurement Act include a regulation that allows foreign-funded projects to mandate the use of foreign contractors, bypassing competitive bidding practices that are considered best practice for transparency and fairness. This is a clear regulatory gap that conflicts with global norms. Chinese loan agreements have likely exploited this weakness in local laws in order to guarantee Chinese procurement for BRI projects in the country. In the case of Pacific Maritime Industrial Zone project project, one PNG civil society organization claimed that 70 percent of the funds are required to be distributed to the main Chinese contractor, which uses Chinese equipment, labor, and technology. Given that the contract is not publicly available, these claims are difficult to verify.

Similarly, the Kumul Submarine Cable Network project likely bypassed a domestic PNG procurement law that mandates competitive bidding. Given the opacity of the procurement process and the prominence of Chinese companies—namely, Huawei Marine and China Import and Export Corporation—as major contractors and sub-contractors on this project, it seems likely that this loophole was exploited.

ALIGNMENT WITH LOCAL NEEDS

The trickle-down effect of large foreign-funded infrastructure projects does not occur if the projects are not accountable to local stakeholders. Bidding processes should be competitive and transparent to give qualified domestic companies a chance to be primary contractors. Fair local procurement could bring economic benefits and create local jobs in the hosting country. However, procurement decisions made behind closed doors between elite government officials and foreign investors lead to unsustainable projects and present opportunities for corruption. Host countries can work to strengthen their regulatory frameworks and transparent reporting and information disclosure practices around foreign investment projects. They should close loopholes that allow foreign donors to bypass competitive and transparent bidding practices, giving domestic potential contractors a chance to be awarded a contract. Bidding documents should also be released to the public to encourage public scrutiny on the decision-making processes for selecting a contractor. An independent infrastructure commission and a special agency for public infrastructure, such as the National Infrastructure Commission (NIC) and the Infrastructure and Project Authority (IPA) in the United Kingdom, could be established to ensure continuity and solicit input on infrastructure projects from local actors and the general public. International pressure should also be applied to investing countries to form more partnerships with domestic firms and consider local needs. Stronger alignment between FDI and local communities is needed in order to ensure foreign-funded projects benefit the domestic economy.