

U4 Expert Answer



The impact of Chinese investments on national procurement rules

Query

What are the inherent risks of Chinese investments undermining national procurement legislation/rules?

Purpose

We need specific information regarding Chinese involvement and investments in Africa. It is being promoted as something new and "fresh" providing Africa with opportunities that neither European private sector nor aid can compete with.

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Summary

Within a decade, China has become a powerful player in the world economy, including global procurement markets. Its participation has been either as a bidder on government and donor projects (including multilateral banks) or as a direct procurer of goods and services by Chinese companies (as a result of lending agreements with countries). China has become one of Africa's largest trading partners, lenders and builders. It uses resource-backed development loans and grants to

countries in return for concessions for and procured goods and services from Chinese companies.

China is not immune from the many risks inherent in procurement, and there have been scandals across different continents involving Chinese companies suspected of using bribery to win contracts. Critics have alleged that China is not complying with good procurement standards, particularly on issues related to labour, the environment and overall governance (transparency, accountability and integrity principles), and perceptions of experts pointing to a concern about Chinese company behaviour abroad.

However, there is currently little specific research that shows China's engagement in procurement offers more risks as compared to other countries. Nor is there a clear indication that China is causing the bar to be set lower in countries where it is involved in procurement markets.

In fact, there are indications that the country's legal framework for anti-corruption is improving. Unlike other G20 countries such as Japan or Germany, China has ratified the UN Convention against Corruption and has also recently modified its domestic legislation to criminalise bribery of foreign officials. Additional comparative research at the country and sector level would be needed to investigate whether China is globally negatively impacting existing procurement practices.

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1 Chinese investment, procurement and bribery: overview of the controversy

Global procurement landscape

Public procurement influences directly the development of countries and the livelihood of their citizens. Procurement involves the acquisition of goods and services – from medicines to water provision; text books to road construction - at all administrative levels of government. Procurement accounts for a large share of government budgets and has been estimated globally at US \$2 trillion every year (OECD, 2002).¹ Governments may derive these monies from aid flows, their own revenues or loans. When goods and services are procured, a public contracting process is launched that involves numerous steps. Given the amounts of money involved, corruption risks are prevalent at each stage. Transparency International has estimated that corruption costs an average of 10 to 25 per cent — and in the worst cases as much as 50 per cent — of a contract's value (Transparency International, 2006).

To counteract these risks, governments have worked to design legislation and norms to promote efficient public procurement and processes that ensure transparency, accountability and integrity. At the same time, laws and standards have attempted to balance these three anti-corruption principles with other good governance objectives, including the efficient management of public resources, fair competition and value for money (OECD, 2007). When funding government procurement through aid, there has been a move towards strengthening national procurement systems in order to increase their use by donors. These aims have been embodied in agreements on aid effectiveness, including the [Paris Declaration](#) (2005) and [Accra Agenda for Action](#) (2008).

¹ This amount corresponds to potentially contestable government procurement markets, i.e. markets where "competitive pricing exists, where there is actual and effective competition, or there is potential competition due to the existence of low barriers to entry to the market". Also see: http://stgpcw.co.uk/eng/issues/choice_commissioning_and_contestability.html.html.

Chinese procurement: an example of worse or best practice?

Academics and others argue that governance advances, such as those overseeing procurement processes, may be threatened as a result of China's increased presence in the international economy (Moran, 2010). China is the second largest economy in the world after the U.S., and it is coming to dominate various sectors – from construction to mining. Such a profile has placed the country as an active and competitive participant in procurement processes undertaken by other countries – from Angola to the U.S.A. This participation is solicited through developing country governments and donor-backed projects. It also is promoted through the Chinese government's contracting of services abroad (as part of related aid and development activities).

Some global companies have levelled charges against their Chinese counterparts, arguing that they do not abide by the same levels of transparency, accountability and integrity when it comes to bidding and other areas of competition (Alden and Davies, 2006). They also have criticised China's business model, which involves the extension of subsidies and low-interest funding to Chinese companies (state and/or private) from state-run banks and export credit agencies. Chinese projects, whether run by the governments or companies, also rely on the use of Chinese labourers, who often make up all or a large share of the human resources used rather than locally-based people. Based on these practices, critics have alleged that China is not complying with good procurement standards, particularly on issues related to labour, the environment and overall governance. As a result, there is a perception that the involvement of Chinese companies in procurement processes may come with increased corruption risks.

However, others have argued that such charges are not well-founded (Brautigam, 2010). They say that Chinese companies do not rely on bribery any more or less than Western companies to seal deals. Also, they point to the fact that Chinese companies do not have a competitive edge in tenders all the time since they do not have the same level of technological know-how as Western companies. Even the subsidies that Chinese companies (namely state-owned enterprises) may receive from the central government are felt to be not enough to skew the advantage (Financial Times, 6 March 2011). This has appeared in the case of China's investment in Angola's oil sector. Although

development loans were extended by China to Angola in return for preferential treatment in the sector's procurement, Chinese oil companies have not been able to win the bids because they do not possess the technology to compete (Corkin, 2011).

2 Procurement process: assessing the role of China

By its nature, procurement has corruption risks at every step (TI, 2010; U4, 2011). These steps include: the needs assessment; preparation; contractor/supplier selection and contract award; contract execution; and final accounting and payment.

Allegations of wrongdoing and bribery have been levelled against Chinese companies along these different stages of the procurement process. The case of Chinese telecom supplier ZTE in the **Philippines**, accused of allegedly providing millions in kickbacks in order to win the contract for the country's broadband network, is just one example of such bribery allegations.

According to the Bribe Payer's Index, produced by Transparency International, Chinese companies were viewed as being the most likely to bribe after the Russians among the 22 countries assessed. Of the respondents, who were business executives from 26 countries, 28 per cent said that Chinese companies use bribery of low-level officials to "speed things up". About the same number (26 per cent) responded that Chinese companies used personal and familiar relationships to win public contracts (Transparency International, 2008).

Despite these allegations and perceptions, there still is a lack of clarity as to whether Chinese involvement in procurement results in higher risks when compared to the behaviour of companies from other countries.

China's comparative advantage: does it undermine the rules of the game?

China is one of the leading actors when it comes to procurement processes globally – including those carried out by national governments and international donors.

Chinese firms are seen as being more competitive than local and other international companies due to their low-cost technology, labour practices and long-term

access to capital (Zadek et al, 2009). This competitiveness applies to government-run contracting processes as well as those done by international donors. For example, Chinese firms have been the second most successful in Uganda at winning contracts worth more than US\$ 1 million for World Bank-funded projects in the country (Ellmers, 2010). But Uganda is not alone. Chinese infrastructure contractors have won more World Bank financed procurement contracts in Africa than any other nationality (Zadek et al, 2009).

When it comes to allegations of sub-standard procurement processes, research suggests that for internationally-backed and government-run projects, Chinese companies tend to be more aligned with the existing rules of the game set by the contracting parties. Field research in Ethiopia and Rwanda shows that Chinese companies in the construction and energy sector are in line with procurement practices of other companies for projects financed by the World Bank, European Union, African Development Bank and other donors (Hackenesch, 2011). However, when projects are directly Chinese financed (either through grants or commercial loans), domestic procurement practices from China also are brought into play, although this depends on the sector and type of financing mechanisms used (Hackenesch, 2011).

It is important to understand these different types of procurement funding (i.e. Chinese-financed or financed by donors and governments) when trying to understand whether China's prominent role in other countries' national procurement processes may be having an impact policies and standards.

China's approach to procurement laws

Chinese companies, as well as any other foreign or domestic firm, would come under national laws when it engages in the procurement processes of another country. Chinese companies would also have to abide by any procurement guideline set up by multilateral donors when participating in their projects. The challenge arises when these laws are not strong enough or implemented sufficiently to combat the risks or demand certain behaviours.

However, there are other remedies that extend beyond the national legislation of the country conducting the procurement process which could be used to counteract risks by placing greater demands on Chinese companies operating abroad. China, along with 150 countries, has signed and ratified the **UN**

Convention against Corruption (UNCAC). This global anti-corruption framework has various anti-corruption measures, including on procurement (Articles 6, 8, 9 and 10). China will have its compliance with the convention officially reviewed in 2014. China also has amended its anti-bribery legislation as of February 2011 to criminalise the payment of bribes to non-Chinese government officials and to officials of international public organisations. Such payments could be used to facilitate the awarding of contracts. This change is seen as bringing the Chinese legislation to the standard of the **OECD Anti-Bribery Convention**. The OECD convention has 38 **signatories** from within and outside of the OECD, including Argentina, Brazil, Chile and South Africa.

China's approach to good procurement principles: transparency, integrity and accountability

Transparency, integrity and accountability are viewed in good practice as the essential elements for effective procurement practices and standards. In considering how Chinese companies perform in these areas, these findings need to be contrasted with the performance of companies from other countries. The debarment list of the **World Bank** demonstrates the cross-section of company nationalities represented – from Italy to the United Kingdom.

Transparency

According to good practice in procurement, it is argued that transparency is needed to help prevent corruption and allow for control mechanisms to function. In this sense, transparency is important even when bidding processes may not be competitive (OECD, 2007). Transparency should characterise each stage of procurement, from the criteria used to evaluate bidders to the provision of information on procurement procedures and regulations.

China's procurement practices have been criticised at times for their lack transparency, both at home and abroad. For example, EU Trade Commissioner Karel De Gucht is trying to adopt a *quid pro quo* stance with China due to its rather closed domestic public-contracts market (Miller, 2010). There are signs of change on the domestic front, however: Although China has not acceded to the agreement on government procurement (GPA) under the World Trade Organisation, it is seen

as trying to move towards these standards which would increase the transparency of its domestic procurement.

When operating abroad, Chinese companies have been blamed for bringing less transparent domestic procurement practices into the country's provision of aid. China is generally known for mixing aid with investment pursuits (LaFraniere and Grobler, 2009). The result of this blending of activities has been the government extending an unprecedented amount of money to developing countries. According to some expert estimates, China has provided more loans over the last two years (2008-2010) to developing countries than the World Bank, signing agreements worth at least US\$ 100 billion (Dyer et al., 2011). Yet China is not part of the donor agreements on aid that guide the OECD members on how aid is to be disbursed or public contracting conducted. As such, China has come to rely on resource-backed development loans to countries, which guarantee the Chinese government (and in turn its companies) a sizeable share of the related procurement contracts (which may or may not be publicly tendered), a practice which can be regarded as less than transparent.

Other donor governments have been criticised for using a similar non-transparent approach in procurement to achieve their own ends. Up until the Paris Declaration, Western governments relied heavily on the tying of aid given to countries. In this process, in return for development assistance funds, a certain percentage of money must be spent on contractors from the donor country (this is particularly prevalent when it comes to technical assistance). The OECD has estimated that an average of 25 per cent of all aid given by donors is still tied in spite of promises to eliminate this practice (Clay et al, 2009). Even when aid is not officially 'tied', Western donors have been found to back businesses from their own countries (Ellmers, 2010).

Accountability

Good practice on accountability in procurement suggests that countries should have various accountability and control mechanisms that involve bidders, other stakeholders and the broader public (OECD, 2007). Accountability activities would include those that open the bidding to public scrutiny and allow for the monitoring of the public procurement process. They would also permit the government to have its own accountability among officials.

The Chinese have adopted an official policy of non-interference when dealing with countries (Bader, 2010). If accountability processes are part of existing practices, then it would be expected for the Chinese to respect this process (whether as part of aid or investment). If accountability mechanisms are not present, then adding accountability controls would likely not occur on the part of the Chinese.

A challenging dimension of accountability is how to ensure companies are held responsible for wrongdoings that are found. China has been criticised in the past for not holding its companies to account for their actions during a procurement process in a third-party country. For example, there is a well-known case from Namibia of government officials allegedly receiving kick-backs from a Chinese company as part of contracting the purchase of its cargo scanners (LaFraniere and Grobler, 2009). Namibian investigators claim that their Chinese counterparts were non-cooperative during the investigation. A major accountability loophole is that it was not possible to prosecute Chinese companies in China that were accused of wrongdoing in procurement processes abroad.

The recent change in the Chinese legal framework seems to bring Chinese legislation to the standard of the OECD Anti-Bribery Convention, and if properly enforced, could have an impact on Chinese companies' business practices when operating abroad.

Integrity

The idea of integrity in public procurement is based on the precepts of transparency and accountability building an overall system that is able to prevent and detect vulnerabilities and risks, including bribery, misconduct and fraud (Heggstad, Froystad and Isaksen, 2010). In practice, integrity should be reflected not only by the process but also in the proper conduct of buyers and suppliers (ABD and OECD, 2006). This conduct extends into the respect for existing standards and practices.

Chinese companies have been criticised for not always abiding by the same standards when they arrive. For example, a study by the International Labour Organization (ILO) of work environments in Tanzania found that 75 per cent of the projects operated by Chinese contractors had below-level labour standards: long working hours, low pay and poor health and safety standards (ILO, 2005). In the case of Ghana, few of the

Chinese firms have signed up to the collective bargaining agreement that exists in the construction sector with trade unions on wages (MacDonald, 2008). In Zambia, it has been alleged that the Chinese mining and construction firms working in the country also do not comply with labour laws, environmental regulations and general health and safety standards (Chilufya Sata, 2007).

Western companies have consistently complained that they are under pressure to respect labour, health and environmental standards which Chinese companies do not, putting them at an inherent disadvantage (Alden and Davies, 2006). However this does not mean that Western companies do not violate such standards or are consistently sanctioned when they violate labour laws, cause ecological damage or do not pay their taxes (Ellmers, 2010). For example, in the case of the European Commission, companies can be debarred for financial and contractual reasons, such as corruption and fraud, but not for violations of social or environmental laws (Ellmers, 2010).

3 Channels of influence on procurement: China's areas of engagement

It is important to understand some of the channels that could allow a country such as China to have lasting influence on procurement laws and practices in other countries. These channels would exist for any major investing country – whether China, France or the US – that came to dominate economically and financially another country or a sector.

One channel of influence is for country to be able to alter the laws and the rules of the game for procurement processes in another country by having a high level of investments there. Aid may serve as another possible channel of impact on procurement policies.

A look at where China is dominant in aid and investment is useful in assessing whether China could influence procurement laws there. As mentioned, the distinction between aid and investment on the part of China is not always clear and the two are grouped together here.

Where is China dominant?

China is a big investor globally across different sectors. For 2010, the flow of China's overseas direct investment (ODI) was **US\$ 59 billion** in 2010, which was invested in 3.125 companies in 129 countries. The preferred **sector** is commercial services (47.3 percent), followed by mining (20.2 percent), manufacturing (10.2 percent) and retail and wholesale businesses (9.3 percent; Ministry of Commerce, PRC, 2011).

Interestingly, most of China's investment growth is in developed markets. The U.S was one of the three most-rapidly growing markets for Chinese investment in 2010, following the European Union (EU), in which Chinese ODI grew by 297 percent, and Japan, where it rose by 120 percent (China Daily, 2011). The fact that China is investing in these markets where procurement laws are advanced and often with safeguards means that these investments would be subject to strong regulatory environments. And given the relative size of the investments, there would not be any channel for influence.

China also has an increasingly important presence in countries and regions where well-established procurement frameworks are not always the rule or strict regulations are enforced. For example, Latin America is the region that has seen the most inflows of investments from China since 2005. Brazil alone has received an estimated US\$ 15 billion. For this same time period, Chinese ODI to Africa has amounted to nearly US \$44 billion. Nigeria has received the largest share of these funds to the region (Heritage Foundation, 7 February 2011).²

In looking at the stock and flow of investment, it is important to note which regions and countries where these amounts would correspond to a large share of the economy or exert dominance in a sector. China is now Africa's largest trading partner, lender and builder. Chinese aid to the region also has doubled in value between 2006 and 2010 (Ministry of Commerce, PRC 2011).

Moreover, China is willing to negotiate investment deals with internationally-assailed governments, as in Sudan

² The data series is based on calculations by the Heritage Foundation that follow through Chinese investments to other regions in the last five years. In this sense, the data for Hong Kong, which is separated in the Ministry of Commerce's figures, is included in other countries' calculations depending on where these investments ended up.

and Zimbabwe, while other countries ban their companies from investing in such places. This policy has also meant that Chinese companies, and more generally the Chinese government, do not get involved in the laws and policies of countries, whether it is for procurement or it is for preferential trade policies (Pasquini, 2010).

Who is involved from China?

Data suggests that the profile of the typical Chinese investment abroad tends to be a large-scale project worth more than US \$100 million. This conclusion is based on a comparison of information collected by independent sources that is then compared against the official Chinese figures for investment (Heritage Foundation, 7 February 2011).

This money can be channelled through individual companies (both private and public) acting as contractors or investors, as well as various state entities. These include the China Investment Corporation (its sovereign wealth fund) and three development banks that the government has set up: the Export-Import Bank of China, the China Agricultural Development Bank and the China Development Bank. The take-over of Volvo by the Chinese carmaker Geely and Chinalco's bid for Anglo-Australian mining giant Rio Tinto provide anecdotal evidence of this trend towards larger companies driving the game.

A survey of medium and small-sized Chinese companies shows very few of these firms are investing abroad. Of the more than 1.300 Chinese companies polled by the China Council for the Promotion of International Trade (2010), only 344 responded that they have invested abroad. Of this total, 61 per cent noted that their overseas investments remained below US \$ 1 million. Only ten of the companies polled had made an investment worth more than US \$ 100 million (CCPIT, 2010).

How does China engage in countries?

A key framework to understand China's approach to investment and aid is **China's Africa Policy**. While it focuses solely on Africa, it sets the tone for how it approaches its activities abroad. This policy was adopted in 2006 and calls for "political equality and mutual trust, economic win-win cooperation and cultural exchange". These points again speak to the country's approach of non-interference in other countries internal processes and the idea of mutual cooperation.

It has been argued, however, that the high-inflow of Chinese investments actually serves as a proxy for policy interference and provides the Chinese government and its companies with the ability to secure concessions in other areas, including the diplomatic ostracizing of Taiwan (Chilufya Sata, 2007). For example, China's Africa Policy explicitly states that the "One China" policy is the political foundation for its relationship with the region.

Moreover, Chinese development loans for resource-rich countries, provided through the Export-Import Bank of China, are backed or guaranteed by the oil, gas and mineral deposits of a country. These have been in use since the 1980s to allow countries with little collateral except what is under the ground to access funds to build roads, schools and clinics and other infrastructure deemed necessary for its development. In the case of Angola, between 2004 and 2010, China extended US\$ 10.5 billion in oil-backed loans through its Export-Import Bank (Corkin, 2011).

Yet many of the countries that have used this mechanism have problems of corruption, transparency and weak procurement systems. In the case of the Democratic Republic of Congo, critics have argued that the lack of transparency of the agreement and public access to the full terms of the agreement are troubling (Global Witness, 2011). The DRC is to receive a US \$6 billion copper-backed loan from the Chinese government. China has agreed to build 2,000 miles of roads and 1,800 miles of railway tracks, as well as schools, health clinics and two airports. In return, China has the right to extract more than 11 million tons of copper and 620,000 tons of cobalt in a 25-year concession (Barboza, 2011). Of the workers hired, 70 per cent are to be Congolese, the remainder Chinese.

Conclusion

While the tenets of good procurement practices may not always be met by all Chinese companies, it is difficult to conclude that existing regulations and norms in Africa and elsewhere are systematically undermined by China's increasingly active investments abroad. Allegations are plentiful, but extensive research is still missing.

While China has directed a large share of its investments to developed countries over the last five years, the majority of the flows tend to be towards emerging or developing countries, particularly those

with natural resource wealth: Nigeria, Brazil, Indonesia, Iran and Kazakhstan. Moreover, given the country's non-interference policy, investments often are directed to countries that other investors ignore (due to risks or their home governments' embargoes).

Where China, or any country, assumes a large presence regionally and nationally in an economy or sector, there is a risk that it could influence existing procurement regulation and norms, particularly if the legislation is weak or it is not effectively implemented. Further research should be dedicated to examining China's influence.

The information that does exist, mostly from Africa, points to the concern that Chinese companies may not be abiding by the accepted levels of transparency, accountability and integrity that are called for based on international guidelines for well-managed procurement processes. However, similar violations have been documented among Western companies.

While Chinese law was long remiss, recent changes to China's legislation should bring it up to OECD standards. This, as well as its implementation of the UNCAC, to which it is a signatory, offers a promise of better enforcement of corruption abroad, including corruption in international procurement.

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