



Imported or Indigenous?

The Multifaceted Character of Corrosive Capital in Chinese Investment Projects.

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Corrosive Capital vs Constructive Capital

Corrosive Capital

DEFINITION: Corrosive Capital is financing, whether state or private, that lacks transparency, accountability, and market orientation.

PROBLEM: Originating from authoritarian regimes, Corrosive Capital exploits and exaggerates governance gaps to influence economic, political, and social developments in recipient countries.

SOLUTION: Increase transparency and accountability around investment to neutralize the effects of Corrosive Capital.

Constructive Capital

DEFINITION: Constructive Capital refers to financial flows that are well-governed at the funding source and destination and respond to market voids.

INDICATORS: Transparent terms and entry into the market, accountable to a wide array of local stakeholders in the recipient country, and justification is based on market principles

BENEFITS: Benefits of Constructive Capital investments include transparent and documented terms, stakeholder accountability, and more.

Source: <https://corrosiveconstructivecapital.cipe.org/>

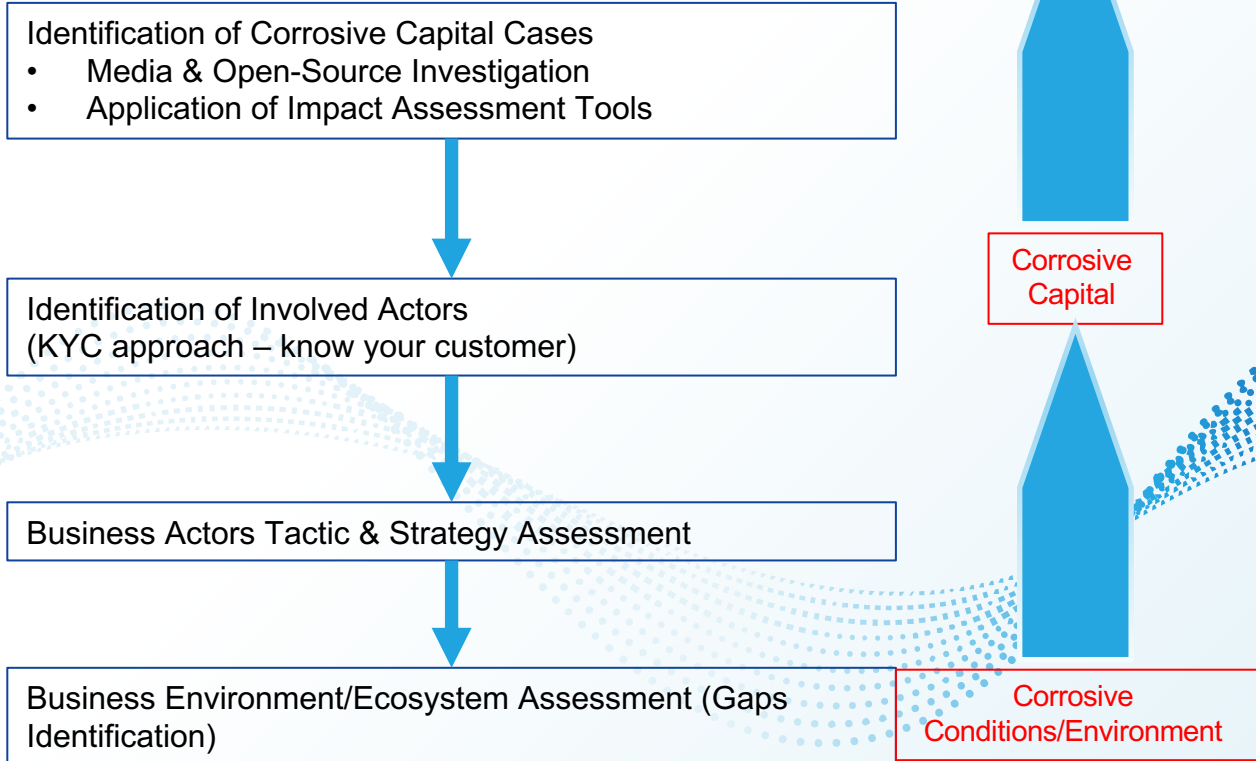
ERODED ENVIRONMENT - “GOVERNANCE GAPS”

Chinese companies tend to take advantage of “weak regulatory environments,” yet weak regulations are often the source of governance gaps, and when China exploits weak regulations in a recipient country the rule of law in a country erodes.(Brautigam 2018)

Weak rule of law and uneven regulatory enforcement are present in almost every transitioning democracy. Those traits also represent some of the gaps in effective democratic governance through which corrosive capital may flow. (CIPE 2019)

CORROSIVE CAPITAL IS EXPLOITING AND WIDENING GOVERNANCE GAPS.

CORROSION SOURCE BACKWARD TRACING



METHODOLOGY

Desk and field research:

- Kyrgyzstan's investment profile and Chinese companies engagement in the country;
- Legal investment framework analysis (local regulations in concern to foreign investments and enterprises with foreign capital in particular sectors);
- Identification of Corrosive Capital Cases (based on media & open-source Investigation);
- Identification of Involved Actors.

Limitations:

- Limited transparency in investment activity (limited access to documents/agreements)
- Limited access to Chinese investors/respondents (business considerations “Money loves silence”, security considerations, COVID-19 travel restrictions)

KYRGYZSTAN AND CHINA'S FINANCIAL FLOWS

- During 2010s China became the top source of Foreign Direct Investment (FDI) in Kyrgyzstan underlying its role as an important force shaping local economic and political landscape.
- FDI is accompanied by official development assistance (ODA)-like financial flows.
- The rapidly growing presence of Chinese capital is accompanied by notorious conflicts between investors and local populations where **stakeholders engage into the blame game instead of taking responsibility and accountability for their actions.**
- It could be identified as a result of **myriad issues (GOVERNANCE GAPS)** constituted by the **absence of specific and concrete guidelines** where state authorities that would oblige investors to apply modern standards focused on the ethical business practices and sustainability like Corporate Social Responsibility (CSR) and Environment and/or Social, and Governance (ESG).

THE DILEMMA

- The national law and regulations in terms of investment policies is internally inconsistent and conceptually colliding.
- The legislative mishmash could serve as important driver fueling conflicts but cannot be seen as an exclusive explanation or justification for investor actions in given investment environment.
- The attempt to explain the conflicts through the effectiveness of the local investment facilitation mechanism cannot be used to obscure the problems resulting from the investor's own behaviors.
- The dilemma whether a certain type of behavior is forced by local configuration, or whether it results from the imported features of a specific investor. (Imported or Indigenous?)

Tracing Corrosive (and also Constructive) Capital in Chinese investments in Kyrgyzstan.

The research analyzed 8 cases of Chinese capital involvement to identify corrosiveness, potential governance gaps and recommendations.

1. **Going cold:** The modernization of the Bishkek Combined Heat and Power (CHP1) by Tebian Electric Apparatus Stock Co., Ltd. (TBEA).
2. **Paved with good intentions:** “Bishkek city road network development & “Bishkek city roads surface rehabilitation” projects by China Road & Bridges Corporation (CRBC).
3. **All that glitters is not gold:** the case of Chinese investments in gold mining sector based on Chinese involvement.
 - a) Resources for Investment. The case of Ishtamberdi gold deposit development by Full Gold Company LLC (affiliated to Chinese state-owned gold mining enterprise Lingbao Gold Company Limited);
 - b) Yellow Fume and Chinese Demarche. The development of Solton-Sary deposit by Zhong Ji Mining LLC (affiliated to state-owned China National Gold Group Corporation (China Gold));
 - c) Not without problems. The development of Taldy-Bulak Levoberezhny by Kyrgyz-Chinese JV Altynken LLC owned by state-owned Kyrgyzaltyn OJSC and Chinese “Superb Pacific” Ltd. (affiliated to Zijin Mining Company Ltd.
 - d) Good Restart (or Reignited). The case of “Makmalzoloto” Gold Mining Plant development by Chinese citizens owned companies JL Makmal Development LLC and “Manson Group” LLC.
4. **The phoenix company.** The case of Kaında Cable Factory asset transfer to “Metall-Ken” LLC (affiliated to Fujian Taihao International Trade Company Ltd.)
5. **Error-prone or problem solving approach.** The case of “Zhongda” refinery in Kara-Balta.
6. **Corroded Corridor.** The case of Abdukadyr’s cargo network involvement in China-Kyrgyzstan-Uzbekistan transport corridor.
7. **Easy does it:** the case of building logistic centers on the bumpy silk road in Kyrgyzstan. Comparative perspective on the Industrial Park “Silk Way” in the Chuy Region and the Industrial-Trade-Logistic Center “At-Bashi” in the Naryn Region.
8. **Cement Storm:** the case of Chinese investments in cement industry in Kyrgyzstan’s part of Ferghana Valley

CONSTRUCTIVE CAPITAL EXAMPLE

The investment of “Manson Group” LLC in the development of “Makmalzoloto” Gold Mining Plant (MGMP).

- November 2018 - competition by “Kyrgyzaltyn” OJSC for the creation of a joint venture on the basis of MGMP setting up main evaluation criteria as the provision of jobs for the local population; the obligatory use of environmentally friendly reagents and modern technologies in the processing of minerals; the period of commissioning of a new gold processing plant and/or modernization of an existing one...
- December 2018 - Three Chinese companies submitted proposals to develop MGMP. All proposed to form a joint venture in which 30% would be owned by Kyrgyzaltyn OJSC, and 70 % by the investor. The competition was won by Manson Group LLC that offered to create 1315 workplaces and invest 75 million USD from its own funds...
- September 2019 MGM resumed works of the gold mine and in March 2020 the existing gold processing plant was put into operation.
The company's activities in the field of enterprise development, as well as social responsibility demonstrated in terms of company employment policies oriented for local residents, employment project development, as well as assistance in the pandemic period proved to be **crisis-tested where employees of MGM defended the enterprise and protected the investor during turbulent time after the 2020 Kyrgyz Revolution.**

Thus, the capital investment of Manson Group LLC in MGM could serve as constructive one.

CORROSIVE CAPITAL EXAMPLE

Cement Storm in the Ferghana Valley

- The cement industry is recognized as highly polluting industry negatively affecting natural environment and well-being of local communities. The enabling and determinant role of Chinese capital in the development of this industry in Kyrgyzstan raises questions of standard-setting and accountability.
- The booming growth of the cement industry in Ferghana Valley with its damaging influence on environment is alarming as it could undermine any effort for sustainable development including those made by international society to manage its scarce resources as land and water. Currently, there are approximately 20 cement plants of different size, annual production, and different operating status.
- As of 2022 there are 7 cement plants in Kyrgyzstan and 4 of them are fully operational - Kant Cement Plant JSC, Kyrgyzstan Southern Cement LLC, Southern Plant of Building Materials LLC and Xinji-Pirim LLC. The last three are located in the Ferghana Valley and have direct or alleged links to Chinese capital.

FINDINGS

Cement Storm in the Ferghana Valley

- The issue is elevated as public and private interests in the industry are often intertwined putting the priority to attract investments above other standards. Close look at the ownership structure of cement projects in the region demonstrates that the lack of transparency is often accompanied with high ranking officials involvement and offshoring practices along with Chinese capital presence.
- The footprint of Chinese companies in Kyrgyzstan's cement industry is multifaceted as they pursue greenfield or brownfield investments, or act as EPC contractors backed by export financing the China Exim Bank. Because of their intense presence Chinese capital shall be seen as determinant one and thus responsible for eventual corrosive effects, and also potential positive changes.

RECOMMENDATIONS

Cement Storm in the Ferghana Valley

- Introduction of obligatory installation of real-time pollution monitoring systems as a regulatory requirement for cement industry in Kyrgyzstan.
- Improvement of the procedure of Environmental Impact Assessment (EIA).
- Obligatory compliance of Kyrgyz and Chinese financial institutions to implement additional politically exposed persons (PEP) screening requirements as part of their Anti-Money Laundering/Combating the Financing of Terrorism Programs.
- International assistance programs to Ferghana Valley especially those related to agriculture shall be reconsidered in line with industrialization programs pursued by respective local and state authorities.

HOW TO RESPOND TO CORROSIVE CAPITAL IN KYRGYZSTAN?

- The analyzed cases demonstrate that investment projects with Chinese capital engagement in Kyrgyzstan frequently fall within the framework of “corrosive capital” as they lack transparency and accountability. However, the complex relationship structure in each investment case cannot attribute formation of conflicts as exclusive responsibility of Chinese capital. It would be inappropriate simplification and diminish role of local stakeholders. Also it shall be underlined that “anti-corrosive” solutions are complex mixtures that must be jointly developed.
- Cover-all character of corrosive capital and the level of penetration in Kyrgyzstan make it difficult to effectively respond. It is clear that governance gaps must be addressed, new regulatory framework created and business practices adopted. It shall be stated that reduction of corrosiveness could be possible only with raising transparency and accountability as immune mechanism towards wide range of corruption.
- It is also important to investigate and address negative effects of corrosive capital as part of public-private dialogue. And the dialogue shall not be limited.

THANK YOU!

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