

The Asia Foundation

CHINESE COMPANIES IN PAPUA NEW GUINEA

OCTOBER 2022

THREE COMPONENTS

I

Primer on Chinese aid and investment in general

II

Country profile of Chinese aid and investment in PNG

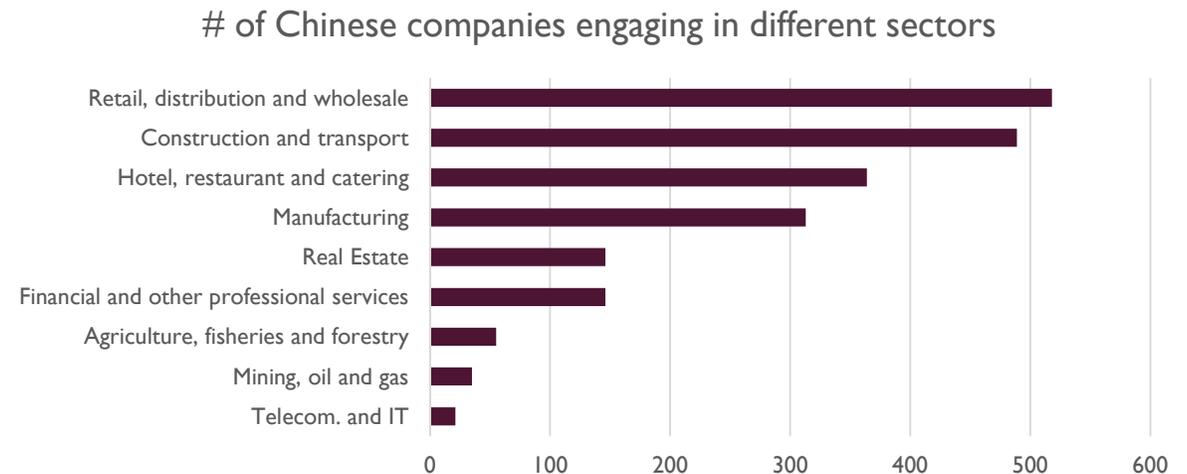
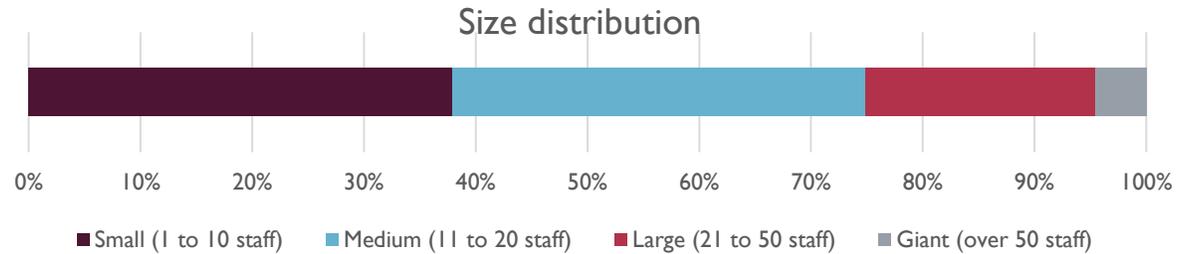
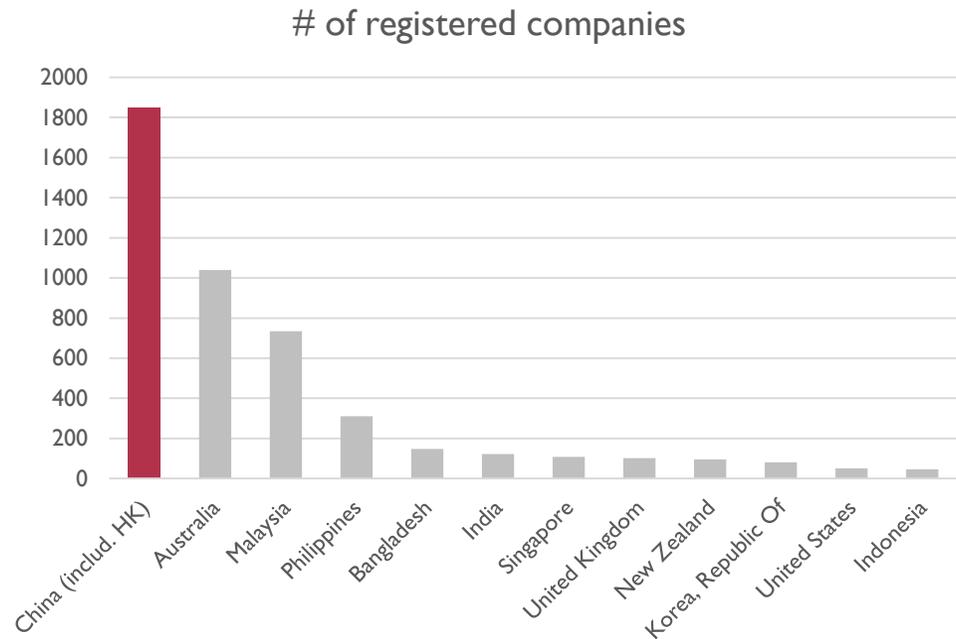
III

Chinese company and investment mapping in PNG

- Chinese companies' current presence in PNG: size and sector distribution
- Trends in engagement: fundings and contracting project values
- Factors driving the trend
- Exception to the trend: company registrations

OVERVIEW OF CHINESE COMPANIES IN PNG: A LARGE PRESENCE

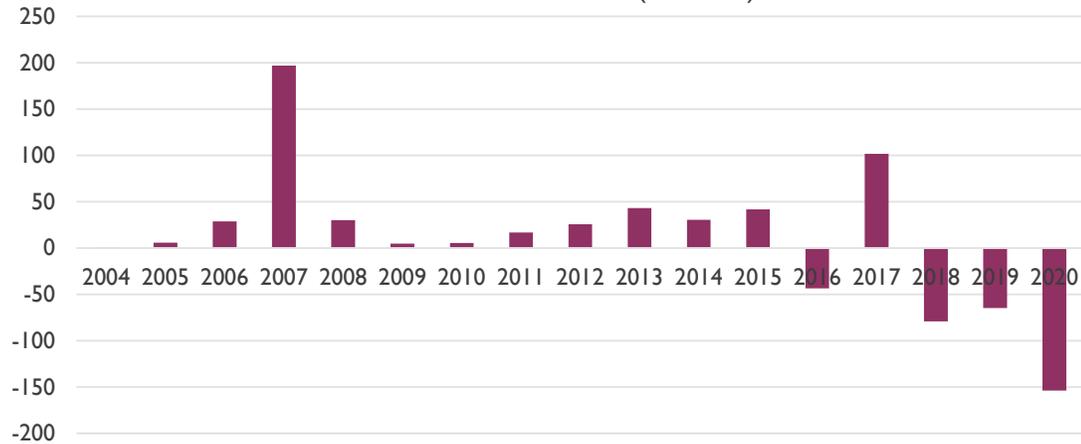
- Over 1800 foreign companies in PNG are controlled by Chinese nationals or Chinese entity
- 75% of them are small to medium companies with 1 to 20 staff
- Many Chinese companies operate in multiple sectors. Retail, distribution & wholesale attracts the most Chinese companies, followed by construction and transport.



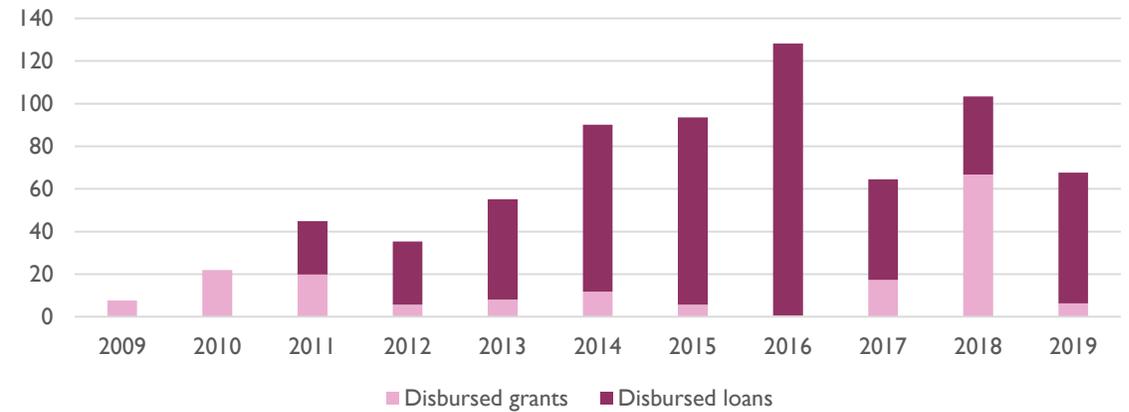
TRENDS IN ENGAGEMENT: DECLINING

I. FUNDING FROM MAJOR SOURCES REDUCES

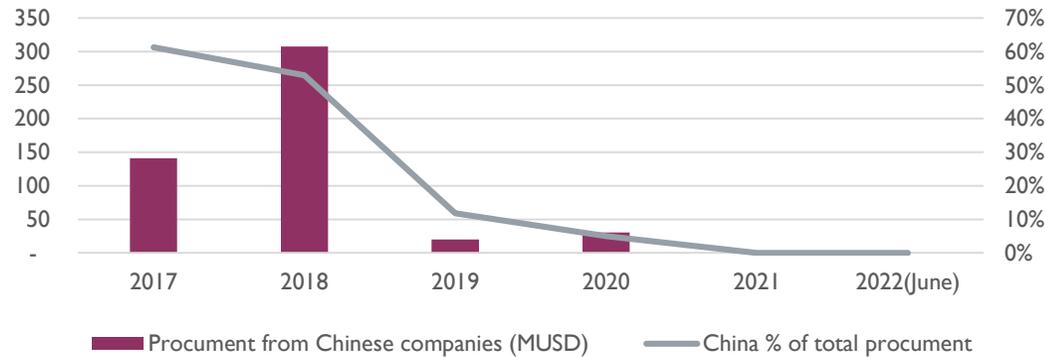
Chinese FDI flows (MUSD)



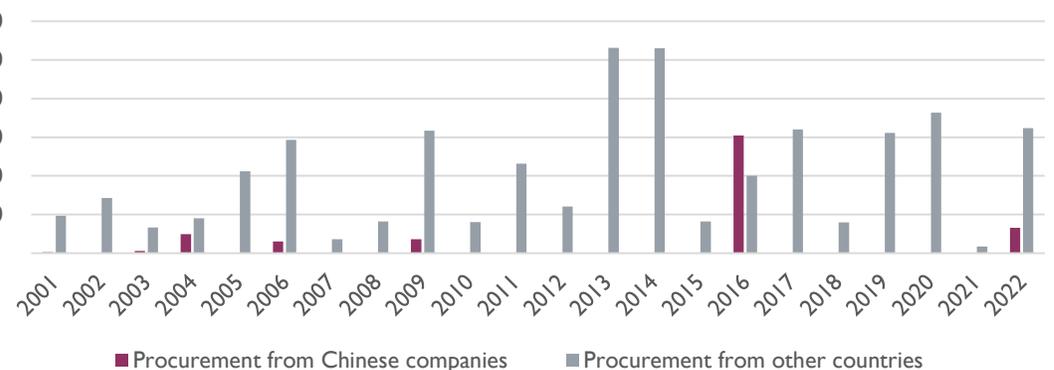
Chinese aid disbursement (MUSD)



ADB procurement from Chinese companies (MUSD)



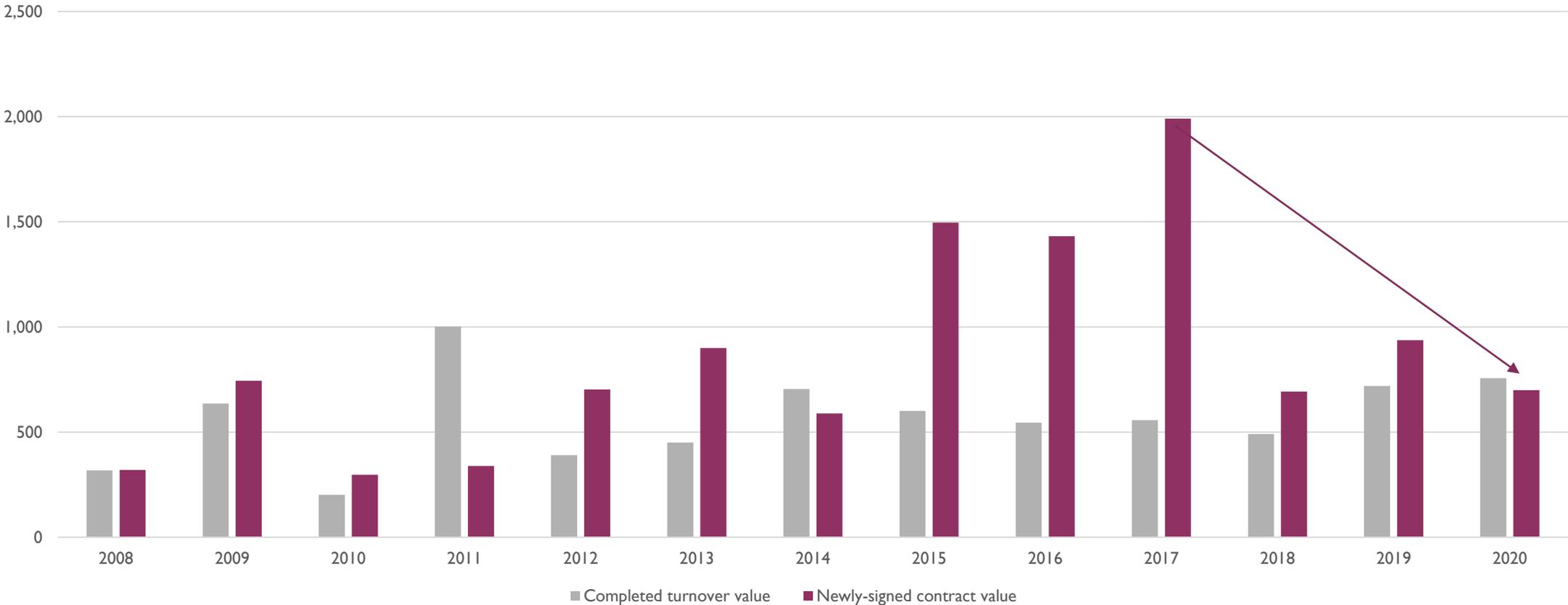
WB procurement (MUSD)



TRENDS IN ENGAGEMENT: DECLINING

II. SIGNING OF NEW PROJECTS SLOWS

Value of China's International Project Contracting in PNG (MUSD)

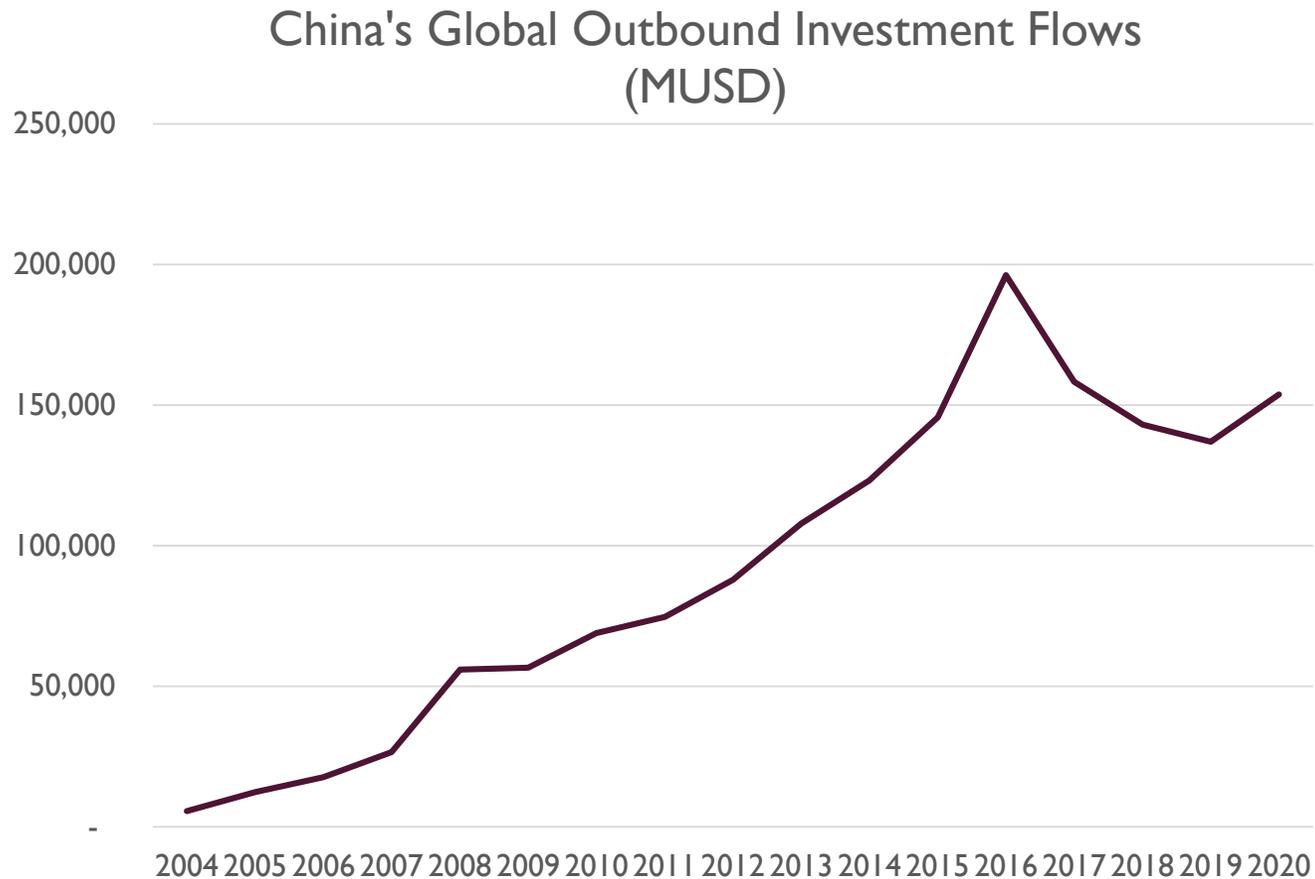


Source of data: China's MOFCOM

WHAT EXPLAINS THE DECLINE?

- Chinese companies' engagement in PNG grows along with China's global expansion since the launch of the BRI in 2013
- Yet, despite PNG's signing of BRI in 2018:
 - All four major sources of funding started decreasing prior to Covid pandemic
 - The signing of new projects has slowed
 - A larger proportion of Chinese companies are operating on Chinese aid projects
- **Why?**
 - Declined outbound Chinese investment globally from 2016 to 2019 due to stricter regulations
 - Intensified competition among large Chinese enterprises
 - Increasing business risks in PNG and growing awareness of the risks among large Chinese enterprises

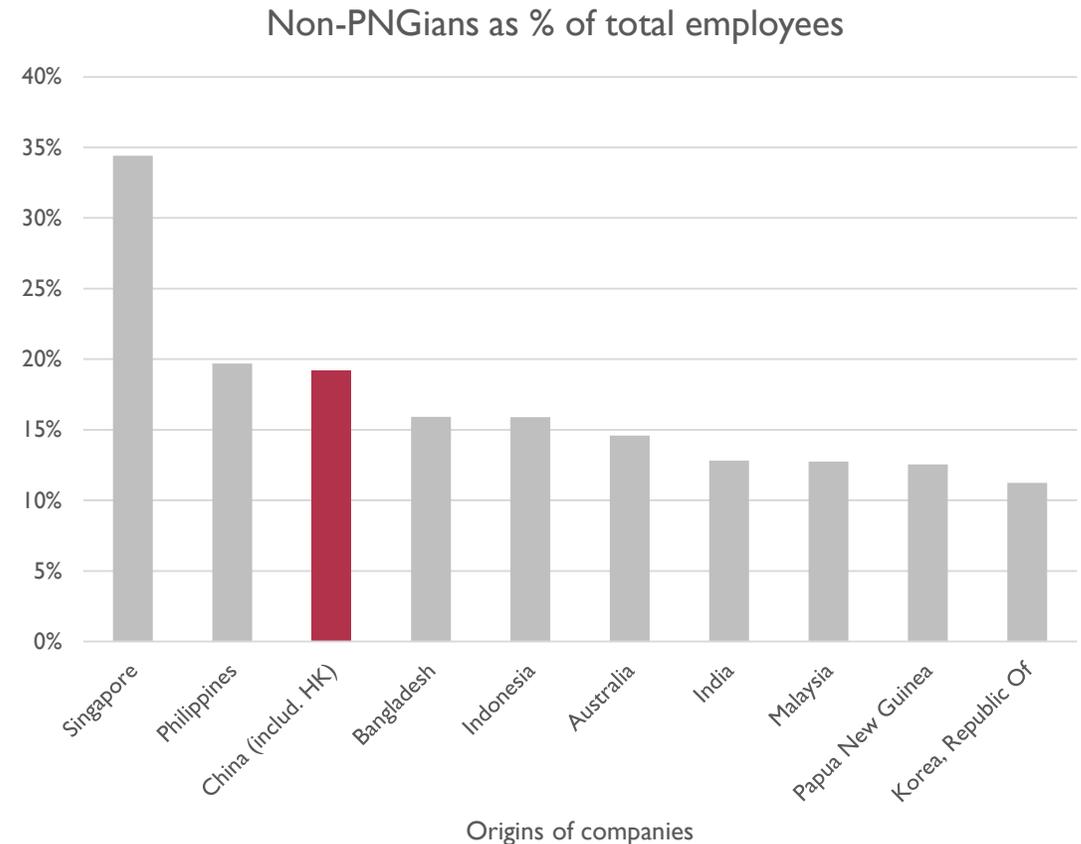
I. STRICTER CHINESE OUTBOUND INVESTMENT POLICIES



- Increasing regulations:
 - Become more detailed and specific
 - Address international concerns: competitive behaviours, green development, and social responsibilities
- Evolving regulatory role of the Chinese state:
 - Transition from pre-screening to full-time monitoring
- Enhanced monitoring capacity:
 - Enhanced by digitalized information platforms, corporate social credit system, and information sharing between key government agencies

II. INTENSIFIED COMPETITION AMONG CHINESE ENTERPRISES

- Competition among big Chinese enterprises in the field of contracting projects has intensified over years
- Competing on both price, speed and financing
 - Requirement for construction speed is the main reason why Chinese companies prefer hiring Chinese workers over local workers
- China PNG Business Council issued the *Guiding Opinions on Preventing Malicious Low Bidding (Trial)* in 2020



III. INCREASING BUSINESS RISKS AND GROWING AWARENESS

- From *China's Overseas Investment and Cooperation in PNG Guide*:
 - 2015: *“Chinese enterprises operating in PNG are generally doing well. More and more Chinese enterprises come to PNG to carry out economic cooperation such as investment, trade, project contracting and labor services.”*
 - 2018: *“Competition among Chinese enterprises in the field of contracting projects is relatively intensive, but there is a lot of room for investment and cooperation in agriculture, tourism, fishery and other fields.”*
 - 2019: *“Some large foreign investment projects were delayed; some government loan projects were cancelled; individual investment projects were unable to land for a long time. The tightening investment policy in PNG and the deterioration of the investment and business environment have affected our enterprises directly and indirectly and created challenges for our enterprises.”*
 - 2021: *“PNG's foreign investment policy has tightened, and the investment and business environment in PNG has become increasingly complex. Some large foreign-funded projects have been delayed and cannot be implemented for a long time, which has affected overseas enterprises' discussion and promotion of projects.”*

III. REPORTED ISSUES RELATED TO CHINESE ENTERPRISES' OPERATION

| Chinese company | Project | Project amount (MUSD) | Funded by | Performance | | | | Governance | | | | | Geopolitical interventions |
|---------------------------|--------------------------------|-----------------------|-------------------|----------------------|------------|---|------------|--|--|-----------------|------------------------------------|----------------------------|----------------------------|
| | | | | Technical deficiency | Work Delay | Labour-related issues (poor treatment, conflicts) | Pollutions | Mismanagement (poor planning, corruption, conflict of interests) | Political uncertainty (change of government, government fragmentation) | Lack of funding | Disputed land ownership/settlement | Insufficient consultations | |
| CHEC | Lae Port Project | 291.4 | ADB, GoPNG | ■ | | | | | | | | | |
| China Railway Real Estate | Noble Centre | 95 | FDI | ■ | | | | | | | | | |
| CJI | Western Pacific University | 46 | GoPNG, ChinaGrant | | | ■ | | ■ | | | | | |
| COVEC | Highlands Region Road | 130 | ADB, GoPNG | | ■ | | | | | ■ | ■ | | |
| CSYIC | Pacific Marine Industrial Zone | 156 | Exim, GoPNG | | | | ■ | ■ | ■ | | ■ | ■ | ■ |
| GDFC | New Enga Hospital | 160 | Exim, GoPNG | | | | | | ■ | ■ | | | |
| Huawei | Integrated Govern Info System | 53 | Exim, GoPNG | ■ | | | | | | ■ | | | |
| Huawei | Kumul Submarine Cable | 270 | Exim, GoPNG | | | | | | | ■ | ■ | | |
| Huawei | National ID Project | 92 | Exim, GoPNG | | | | | ■ | | ■ | | | |
| Jiangsu International | Kokopo Town Sewerage | 35 | Exim, GoPNG | | | | | | | | ■ | ■ | |
| MCC | Ramu Nickle Cobalt | 2040 | FDI | | | ■ | ■ | | | | ■ | ■ | ■ |
| Zijin | Porgera Gold Mine | 300 | FDI | | | | ■ | | ■ | | | | |
| CRIG | Integrated Agriculture Park* | 600 | FDI | | | | | | | | ■ | ■ | |
| Fujian Zhonghong | Daru Fishery Industrial Park* | 200 | FDI | | | | | | | | | | ■ |
| Huawei Marine | PNG-Sol Submarine Cable ** | - | - | | | | | | | | | | ■ |
| PanAust | Frieda River Copper-Gold* | 5200 | FDI | | | | | | | | ■ | ■ | |
| Shenzhen Energy | Ramu2 Hydropower* | 939 | FDI (PPP) | | | | | ■ | ■ | | | | |

* To be implemented ** Rejected

■ Chinese side ■ PNG side ■ Multi-country

IMPACT ON CHINESE ENTERPRISES' OPERATION

Performance issues

- Remedial measures lead to extra costs, undermining project profitability
- Performance subjects to strong media scrutiny, affecting company's global reputation and competitiveness

Governance issues

- Frequent changes in political leadership, and transfer of project between departments cause lack of coherence in public policies and national investment plans
- Lack of counterpart funding and local community interventions (esp. about land-using rights) cause prolonged project delay, increasing supply chain coordination and personnel arrangement difficulty

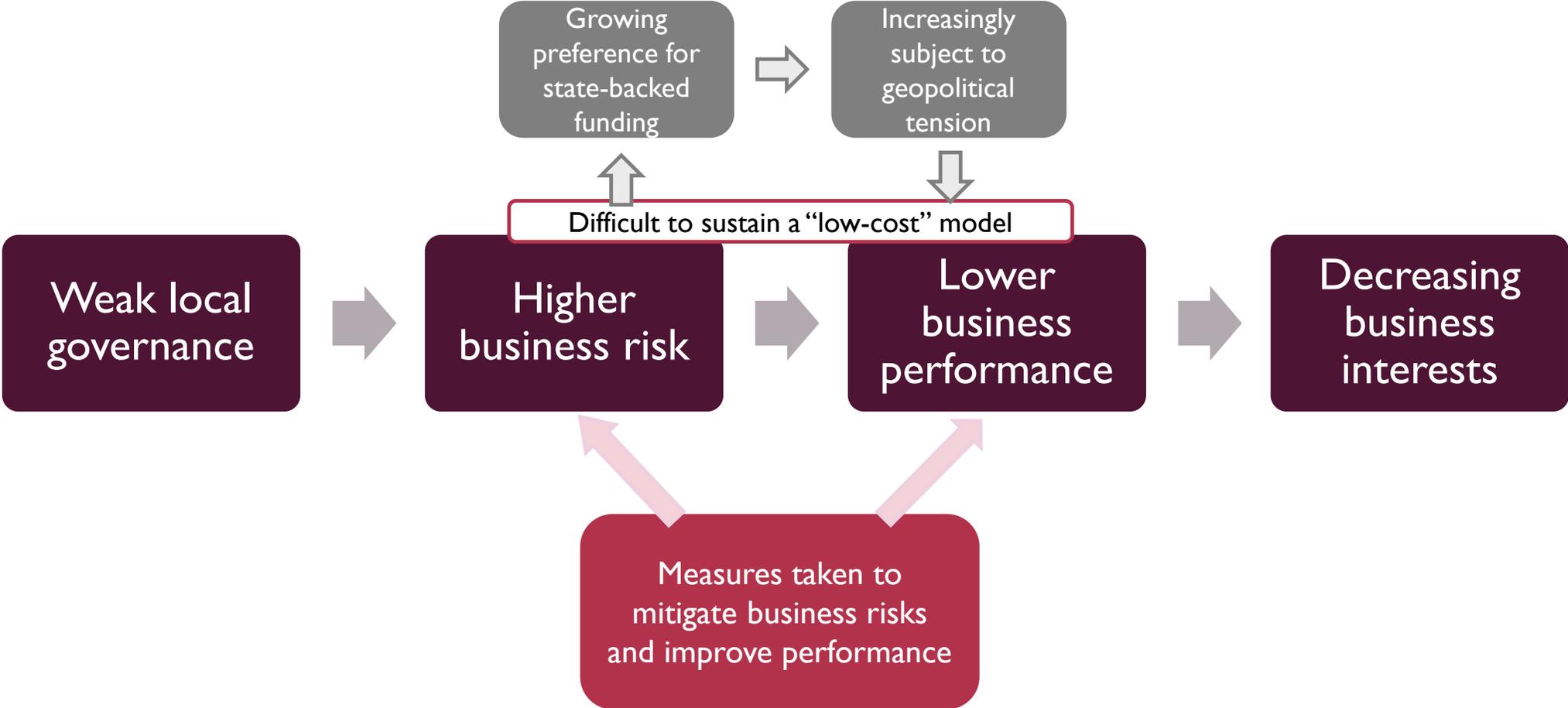
Geopolitical interventions

- China-Australia geopolitical competition complicates project contracting process and contributes to negative media coverage about Chinese companies

Other non-reported issues

- Payment risks concerned about PNG's high debt level, foreign exchange rationing and local banks' strong market power
- Heightened costs resulted from lack of input materials locally, poor social security and law enforcement
- Difficulty to acquire and retain local talents for complicated tasks and senior positions

WHAT IS BEHIND THE DECREASING ENGAGEMENT?



RESPONSE TO ISSUES AND CHALLENGES

■ Business risks management

- Improved market research and project budgeting through accumulation of experience and information exchange among Chinese companies
- Risk mitigation using insurance products and protective clauses in project agreements
- Preference of undertaking aid projects backed by Chinese State funds and multilateral banks
- Close engagement with Chinese embassies/authorities throughout project lifecycle



■ Impact management

- Increasing emphasis on corporate social responsibility and local community engagement
- Cooperation with third-country organizations in monitoring environmental and community impact
- Programmatic responses to accusations and disputes through official or legal channels

■ Labour management

- Dedicated management resources to care for employee/contractor health and safety
- Increasing engagement with local unions
- Localization: talents and scholarship programs



PROBLEMS IN CHINESE COMPANIES' RESPONSE

Slow and passive

- Strong tendency to avoid public attention
- Preference to solving issues in private and reaching agreement with authorities

Lacking transparency

- Generally, no detail or explanation revealed on standards that Chinese companies follow
- Lack of public evidence to support denials to accusations

Unable to address root problem – PNG's poor governance

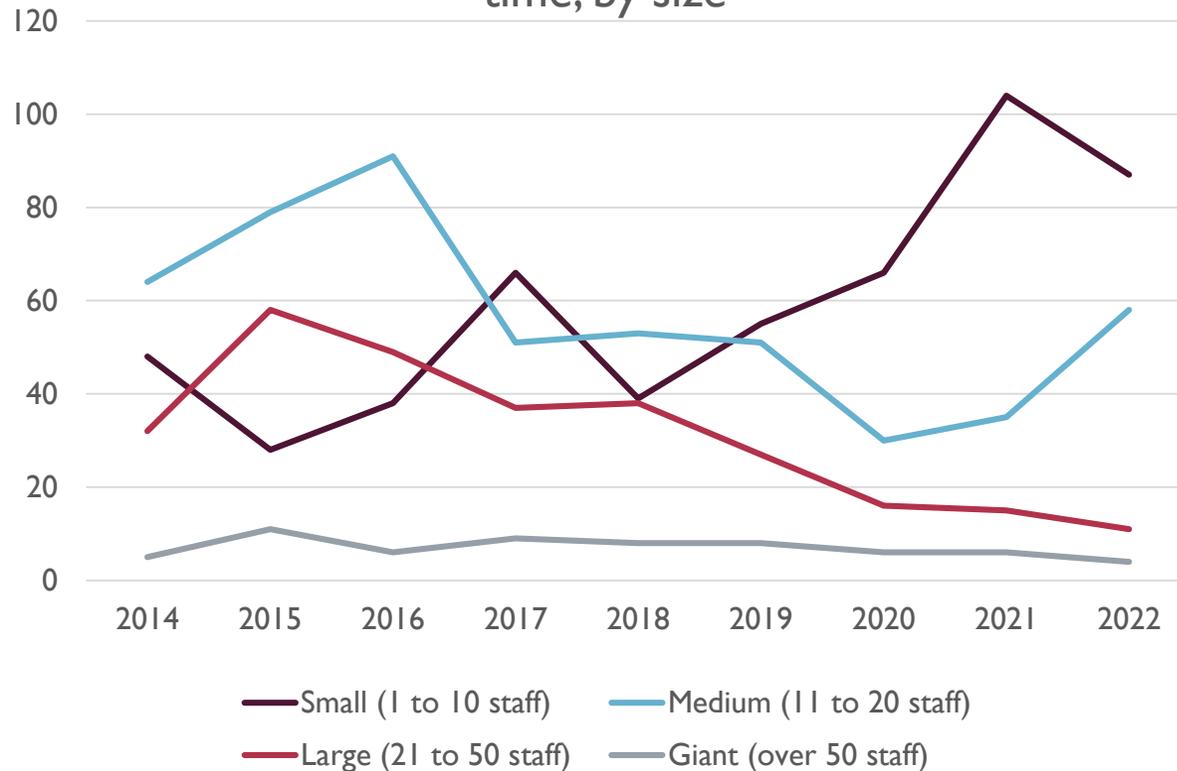
- Most measures are only tentative responses to issues caused by poor governance, rather than solutions
- Require self-discipline to set and comply with standards while pursuing and defending commercial interests

Costly

- Resulted in more pre-contract scrutiny and higher required profitability to cover higher risks
- Undermine Chinese companies' investment interests in PNG

EXCEPTION TO THE STORY: INCREASING NUMBER OF SMALL CHINESE COMPANIES

New registrations of Chinese companies over time, by size



■ Increasing small Chinese companies:

- Profitable operation and positive attitude towards economic prospect in PNG
- Tend to register different companies for different activities when expanding business to reduce risks

■ Regulatory challenges:

- Often negatively perceived in PNG
- Beyond the scope and capacity of Chinese Government's supervision

KEY TAKEAWAY

- Stricter Chinese regulations, intensifying competition and most importantly, the challenges of local governance issues and geopolitical interventions have impacted large Chinese enterprises' performance and reduced their profit returns, driving down the overall Chinese companies' engagement in PNG;
- Many Chinese companies have improved business risks management, impact management, and labour management to respond to the issues and challenges;
- Yet, those responses are problematic themselves and are unable to solve the problems;
- With increasing business risks and growing awareness of those risks, Chinese companies' investment interests in PNG started declining even before Covid;
- In contrast, small Chinese companies remain profitable and are increasing investment.

Therefore,

- In principle, Chinese companies' engagement in PNG is motivated by commercial profitability;
- It is in all parties' interests to enhance PNG's governance to maintain a nonfraudulent and sustainable rule-based business environment;
- PNG and China need to strengthen supervision of the large and growing number of small Chinese companies.