



## RESEARCH BRIEF

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# Corporate Social Responsibility along the Chinese Financed Railway Mega-Project in East Africa

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### Key Points:

- Chinese enterprises have increasingly included corporate social responsibility (CSR) directives in their corporate strategy and are making notable progress toward defining and applying CSR.
- Despite progress in CSR, in the name of the principle of non-interference, the largest Chinese State-Owned Enterprises (SOEs) operating in Africa have adapted to the low regulatory standards of host countries.
- Negative externalities ensue when SOEs adapt to the low standards of host states, and host states are willing to bypass their own rules to attract much needed foreign investment.
- CSR approaches need to be more specific and increasingly mandatory, and should be accompanied by appropriate sanctions for underperforming companies.

### Corporate Social Responsibility in China

Since the launch of the Belt and Road Initiative (BRI) in 2013, China has become an important country for development financing, especially for large infrastructure projects. In 2009, its official finance reached US\$70 billion and in 2016, its outward Foreign Direct Investments (FDI) surpassed its inward FDI making China the third-largest exporter of FDIs in the world.<sup>1</sup> Such investments and financing can create political leverage and also have profound repercussions on a host country's legal, economic, and political systems. Given the global scope of its development financing, many commentators have expressed concern that China is setting a new development paradigm that discards the Western model aimed at promoting good governance, best practice, high standards, and a comprehensive approach to development involving the rule of

<sup>1</sup> AidData, *China's Global Development Footprint*, <https://www.aiddata.org/china-official-finance> (last visited March 5, 2020); Congressional Research Service, *China's Economic Rise: History, Trends, Challenges, and Implications for the United States* (June 25, 2019),

<https://fas.org/sgp/crs/row/RL33534.pdf>; Deborah Brautigam & Jyhjong Hwang, *Eastern Promises: New Data on Chinese Loans in Africa, 2000-2014*, China Africa Research Initiative Working Paper 4 (2016), <http://www.sais-cari.org/publications>.

law, debt sustainability and social and environmental responsibilities.<sup>2</sup>

Although China still lacks an overarching law governing overseas commercial and foreign assistance activity, it has started to emphasize the importance of higher standards and the relevance of environmental and social impact.<sup>3</sup> With its 'Going Out' policy, launched in 1999, China's government began to focus on CSR and, with the launch of the BRI, it has become imperative for China and its companies to improve their social and environmental performance abroad. Not only must they meet host countries' increasingly higher expectations and standards, but they also have to succeed in an increasingly competitive global market where sustainable development matters.<sup>4</sup> CSR is usually understood as consisting of companies' self-regulated and market-driven efforts, often responding to the needs of civil society, toward and beyond host countries'

minimum governance standards.<sup>5</sup> Because China's major economic actors abroad are SOEs, however, its current approach to CSR has been labelled state-centric and is characterized by being less market-driven, as Chinese companies simultaneously promote profit maximization and political goals.<sup>6</sup> While this allows the government to directly mandate, facilitate, and endorse Chinese companies' efforts abroad, to implement national policies, and to encourage more convergent and less voluntary approaches to CSR, possible downsides include the continual dependence on central government resources and a lack of real consideration for civil society and market actors.<sup>7</sup>

In 2006, CSR was included in Article 5 of the Chinese Corporate Law and, in 2008, new Guidelines were issued that encouraged the publication of CSR and sustainable development performance reports.<sup>8</sup> China's regulatory approach

<sup>2</sup> Ian Taylor, *China's Environmental Footprint in Africa*, CHINADIALOGUE (Feb. 2, 2007); Xiaofang Shen, *Private Chinese Investment in Africa: Myths and Realities*, DIPLOMATIC POLICY REVIEW 33 (1) 17 (2013); Dylan Gerstel, *It's A (Debt) Trap! Managing China IMF Cooperation Across the Belt And Road*, Center for Strategic & Internal Studies: New Perspectives in Foreign Policy (Oct. 18, 2018), <https://www.csis.org/nfp/its-debt-trap-managing-china-imf-cooperation-across-belt-and-road>; SIMONE RAUDINO, DEVELOPMENT AID AND SUSTAINABLE ECONOMIC GROWTH IN AFRICA: THE LIMITS OF WESTERN AND CHINESE ENGAGEMENTS (2016).

<sup>3</sup> UNDP, *2017 Report on the Sustainable Development of Chinese Enterprises Overseas. Supporting the Belt and Road Regions to Achieve the 2030 Agenda for Sustainable Development*, <https://www.cn.undp.org/content/china/en/home/library/south-south-cooperation/2017-report-on-the-sustainable-development-of-chinese-enterprise.html>

<sup>4</sup> MENXING LU, CORPORATE SOCIAL RESPONSIBILITY AND ENVIRONMENTAL RESPONSIBILITY. ANOTHER ROAD TO CHINA'S SUSTAINABLE DEVELOPMENT 17 (2018).

<sup>5</sup> David Levy & Rami Kaplan, *Corporate Social Responsibility and Theories of Global Governance*, in THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY (2018), 439; Larry

Ribstein, *Accountability and Responsibility in Corporate Governance*, NOTRE DAME L. REV. 81 1444-1447.

<sup>6</sup> Victoria Ho, *Beyond Regulation: A Comparative Look at State-Centric Corporate Social Responsibility and the Law in China*, VAND. J. TRANSNAT'L L. 46 375-442 (2013); Liwen Lin & Curtis Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, STAN. L. REV., 65 697-75 (2013); DOREEN MCBARNET, *Corporate Social Responsibility beyond Law, through Law, for Law: The New Corporate Accountability*, in THE NEW CORPORATE ACCOUNTABILITY: CORPORATE SOCIAL RESPONSIBILITY AND THE LAW (2007).

<sup>7</sup> Bingyu Liu, *China's State-Centric Approach to Corporate Social Responsibility (CSR) Abroad: A Case Study in Africa*, A Dissertation Submitted in Partial Fulfilment of the Requirements for the Degree of Doctor of Philosophy in the Faculty Of Graduate And Postdoctoral Studies (Law), The University Of British Columbia, 17-18, 21-22 (2019). Meng Liu, *Is corporate social responsibility China's secret weapon?* WORLD ECONOMIC FORUM (Mar. 17, 2015), <https://www.weforum.org/agenda/2015/03/is-corporate-social-responsibility-chinas-secret-weapon/>; Ho, *supra* note 6, at 425.

<sup>8</sup> State-owned Assets Supervision and Administration Commission of the State Council (SASAC), *Guidelines to the*

to CSR has become increasingly comprehensive and shows awareness of the importance of projecting a good image and avoiding risks and losses.<sup>9</sup> While some recent regulations apply specifically to BRI projects, the general principles remain constant and include financial, environmental, and social integrity and consideration and avoidance of risk factors. Chinese economic actors are encouraged to utilize both Chinese and host-country consultants for legal issues, tax, and accounting issues; they also have to comply with both Chinese and local laws and regulations, and pay attention to international best practices and standards, such as the UN Global Compact, the Equator Principles, and OECD Guidelines for Overseas Companies.

### Case Studies

While studies show increased Chinese efforts to improve engagement with host-country communities and employers, and Chinese CSR performance achieved its highest level in 2017,<sup>10</sup> a study of 1,814 BRI-related projects from 2018 found that approximately 270 had issues related to debt, labor and environmental standards, punctuality, national security, and corruption.<sup>11</sup> This is unsurprising; China's globalism is new, and the

massive infrastructure projects it is investing in through the BRI are inherently risky and full of difficulties that are often further complicated by the weak institutional and legal regimes of host countries in the developing world. For instance, in Africa, Chinese-financed railways and other infrastructure projects have faced challenges such as a lack of debt sustainability, non-transparency, corruption, low economic efficiency, a low degree of localization, lack of participation from private and international investors, and environmental degradation. Improving governance has become extremely important for China when implementing the BRI in Africa to ensure economic and reputational returns. However, while Chinese entities could contribute to the governance of a planned project by including social and environmental standards in the contract, rules and guidelines on CSR issued by Chinese central government and SOEs tend to adapt to the host country standards and implementation.<sup>12</sup>

Two railway megaprojects in Ethiopia and Kenya, both completed in 2016–17 and included in the BRI's success story, were described by some local African and Western media as not being

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*State-owned Enterprises Directly under the Central Government* (2011) [http://en.sasac.gov.cn/2011/12/06/c\\_313.htm](http://en.sasac.gov.cn/2011/12/06/c_313.htm); Yanfei Wang, *SOE foreign investment risk curbed*, CHINA DAILY (Dec. 19, 2017), [www.chinadaily.com.cn/a/201712/19/WS5a383e86a3108bc8c67357f8.html](http://www.chinadaily.com.cn/a/201712/19/WS5a383e86a3108bc8c67357f8.html).

<sup>9</sup> *Id.*

<sup>10</sup> GoldenBees, *The 2017 Golden Bees Chinese Companies' Corporate Social Responsibility Report*, <http://images.mofcom.gov.cn/csr/201712/20171219174229375.pdf>.

<sup>11</sup> Jamie P. Horsley, *China Promotes Open Government as it Seeks to Reinvent Its Governance Model* (Feb. 22, 2016), <http://www.freedominfo.org/2016/02/china-promotes-open-government-as-it-seeks-to-reinvent-its-governance-model/>; James Kynge, *China's Belt and Road projects drive overseas*

*debt fears*, (Aug. 8, 2018), [www.ft.com/content/e7a08b54-9554-1e8-b747-fb1e803ee64e?mc\\_cid=1be724dd13&mc\\_eid=4f18c05255](http://www.ft.com/content/e7a08b54-9554-1e8-b747-fb1e803ee64e?mc_cid=1be724dd13&mc_eid=4f18c05255); Gerstel, *supra* note 2; Basten Gokkon, *Environmentalists Are Raising Concerns Over China's Belt and Road Initiative*, PACIFIC STANDARD (July 18, 2018), <https://psmag.com/environment/environmental-concerns-over-chinese-infrastructure-projects>; International Crisis Group, *China-Pakistan Economic Corridor: Opportunities and Risks* (June, 29 2018), <http://www.crisisgroup.org/asia/south-asia/pakistan/297-china-pakistan-economic-corridor-opportunities-and-risks>.

<sup>12</sup> Xiaoxue Weng & Lila Buckley (eds.), *Chinese businesses in Africa. Perspectives on corporate social responsibility and the role of Chinese government policies*, IIED Discussion Paper, 2016, at 25.

economically sustainable and with poor social and environmental impact. The 752km Addis Ababa-Djibouti Railway (ADR) was inaugurated on October 5, 2016, and the 480km Mombasa-Nairobi Standard Gauge Railway (SGR) on May 30, 2017. Both the railways link capital cities to ports; landlocked Ethiopia's capital is now linked to the deep-water Djibouti Port, in which China has interests and where it established its first overseas naval base, while in Kenya the SGR connects the capital to the port city of Mombasa. The projects were both financed mainly by China Exim Bank<sup>13</sup> and constructed by Chinese SOEs: the China Road and Bridge Corporation (CRBC) for the SRG, and primarily the China Railway Engineer Corporation (CREC) for the ADR. While the SGR was immediately used for passengers and soon also for freight, the ADR has suffered significant operational and financial issues since its inauguration.<sup>14</sup>

### Implementation

Despite the various guidelines issued by the Chinese central government to promote sustainable financing, the Chinese loans have put both Kenya and Ethiopia in debt distress. Kenya owes US\$5.3 billion to China, and, just for the SGR, it took out a loan for US\$3.2 billion, 56% of the country's Gross Domestic Product (GDP).<sup>15</sup> It is possible that with its various loans, including the

one for the SGR, Kenya's debt level will either breach the East African Community 50% debt/GNP imposed ratio or will force Kenya to curtail its borrowing.<sup>16</sup> Due to the fact that the SGR is still far from reaching its goals, Kenya's government, under pressure from the China Exim Bank, introduced a new railway development levy in 2013 of 1.5% of customs value on imported goods and forced companies to use SGR freight. Ethiopia was the second-largest recipient of Chinese infrastructure investment commitments from 2009 to 2012. It has invested US\$4.4 billion in roads and railways since 2007, and it owes a large part of this finance to China.<sup>17</sup> However, the situation in Ethiopia is even worse than in Kenya for debt sustainability and economic returns from investments. The ADR railway continues to run into operational difficulties, and it is not clear how the country is going to repay its debt. In both Kenya and Ethiopia, China Exim Bank has been willing to re-negotiate the debt. However, it remains unclear what will happen in the case of a default on loan repayments and the implications for Chinese political influence in the future. Ultimately, China Exim Bank expects the two countries to repay their debt, and these examples illustrate the potential risks for African countries with respect to loan repayments.<sup>18</sup>

<sup>13</sup> Kenya Standard Gauge Railway was financed by the Government of the Republic of Kenya (15%) and China Exim Bank (85%). Its total cost was US\$3.804bn. The Ethiopia-Djibouti Railway was financed by the Ethiopian Government (30%) and China Exim Bank (70%), and its cost was US\$4 bn, of which the Ethiopia contribution was US\$3.4 bn.

<sup>14</sup> Interview with Director-General of Ethio-Djibouti Railways in July 2019 in Addis Ababa; Ismail Einashe, *Letter from Africa: I gave up on catching the train in Ethiopia* (Sept. 9, 2019), [www.bbc.com/news/world-africa-49580863](http://www.bbc.com/news/world-africa-49580863).

<sup>15</sup> Republic of Kenya, *Statistical Annex to the Budget Statement for Fiscal Year 2018/19*, (2019).

<sup>16</sup> Shakira Mustapha & Romilly Greenhill, *An 'age of choice' for infrastructure financing? Evidenced from Kenya*, Overseas Development Institute Report, 2017, at 31.

<sup>17</sup> Jamie Farrell, *How do Chinese Contractors Perform in Africa? Evidence from World Bank Projects*, Johns Hopkins SAIS-CARI Working Paper 3 (2016), <https://static1.squarespace.com/static/5652847de4b033f56d2bdc29/t/573c970bf8baf3591b05253f/1463588620386/Working+Paper+Jamie+Farrell.pdf>.

<sup>18</sup> Brautigam & Hwang, *supra* note 1.

Besides the non-concessional terms of the loan agreement that the China Exim Bank wanted to keep secret in both cases, Chinese SOEs adapted to both the regulations and weak law implementation (and often corruption) of host countries when it came to social and environmental responsibility. The two railway projects developed different CSR and public relations approaches and capacities despite China's state-centric CSR.<sup>19</sup> In Kenya, the Chinese contractor for the SGR operations, the China Communications Construction Company (CCCC), faced an engaged civil society and free media. It published a CSR report in 2016 and used social media platforms forbidden in China, such as Facebook and Twitter, to connect with the local people. One of the contractors for the ADR, China Civil Engineering Construction Corporation (CCECC), published a CSR report only in 2019, and its public relations efforts were more limited and less sophisticated.

As part of their CSR efforts and host country's demands, the Chinese SOEs in both cases put in place strategies to hire workers locally. Kenya seemed to be more active in imposing a quota of workers, and Chinese SOEs adapted to the request. As CSR report by CRBC suggests, Kenya, in locally sourcing 40% of its materials and employees for the project, benefitted more from the Chinese loans than Ethiopia.<sup>20</sup> In Ethiopia, the government seemed weaker in imposing quotas for local labor and also in ensuring useful

technology transfer, sourcing only around 25–30% of material and employees locally.<sup>21</sup> Regardless of scale, in both Kenya and Ethiopia the projects created new jobs for local people and new training opportunities. A recent analysis of labor and Chinese companies showed that Chinese and local workers are paid the same; labor conditions and wages depend on sector rather than on the workers' country of origin.<sup>22</sup> Local hiring, however, did not prevent labor disputes raised due to poor treatment and low salaries. Very often, these clashes were caused by different interpretations of labor law by Chinese and local counterparts. However, the Chinese SOEs seemed to respond quickly, and used local courts to solve labor disputes.

One of the major issues in both cases was land expropriation. The Chinese SOEs were not directly responsible for this; host country governments were responsible for relocation and land compensation. But the process was soured by local corruption and, in the case of Kenya, local clientelism and lack of implementation of the law, with the Office of the President bypassing national laws. Also, with respect to the environment, Chinese SOEs tended to follow local regulation, to which they added, in some cases, layers of sophistication (e.g. Exim Bank's pre and ex-ante Environmental and Social Impact Assessment), although sometimes this addition was more rhetorical than substantial. Overall, while the environmental record of Chinese economic actors

<sup>19</sup> Wang, *supra* note 8.

<sup>20</sup> CRBC, KENYA SGR PROJECT SOCIAL RESPONSIBILITY REPORT 2017/2018 (2018), <http://en.goldenbeechina.com/News/show/id/87>.

<sup>21</sup> Yuan Wang, *The Politics of Sino-Africa Infrastructure Development*, MSc in Politics Research, Oxford University (2019); Yuan Wang & Uwe Wissenbach, *Clientelism at work? A case study of Kenyan Standard Gauge Railway project*,

ECONOMIC HISTORY OF DEVELOPING REGIONS, 34 (3) 280-299 (2019); *Ethiopia-Djibouti Railway Line Modernisation*, RAILWAY TECHNOLOGY (2019), [www.railway-technology.com/projects/ethiopia-djibouti-railway-line-modernisation](http://www.railway-technology.com/projects/ethiopia-djibouti-railway-line-modernisation).

<sup>22</sup> Carlos Oya, *Labour regimes and workplace encounters between China and Africa*, SOAS IDCEA Working Paper 05 (2018).

in Africa does not necessarily differ from that of other nations, the major issue is that they often work in industries and mega-projects that are more socially and environmentally impactful than those financed by Western banks.<sup>23</sup>

### Conclusion

While it is challenging to measure the direct effects and potential impact of infrastructure projects, these two railway mega-projects are likely to create positive economic benefits for the host countries in the long-term, and Chinese economic actors seemed quick to learn from their mistakes and to adopt improved approaches. In both the SGR and the ADR examples, Chinese SOEs did at least produce CSR reports and made a clear effort to improve their social and environmental impact.

Due to China's non-interference approach, performance, impacts and consequences are often determined by the host country's regulations, due diligence and risk management processes.<sup>24</sup> Chinese economic actors working abroad are increasingly aware of host-country laws and regulations; they also adapt to host-country unwritten laws, including social norms and local institutional practices, including corruption and clientelism. In Kenya, the Office of the Presidency bypassed its laws to complete the SGR on time in order to support the election of Kenyatta. At the same time, its vibrant civil society and free media

stimulated those in power to foster local inclusiveness, such as adding clauses to the SGR contract requiring the hiring of a percentage of local labor. It also forced Chinese SOEs to be much more active in their approach to public relations, to be seen to address public concerns and to issue the first CSR report in 2016. Although there are an increasing number of specific regulations and guidelines on CSR from the Chinese central government, the Chinese SOEs involved in the construction of the two railway mega-projects did not seem particularly aware of them. The main issue is that these regulations and guidelines cannot be enforced - compliance is mostly voluntary, and the language remains largely vague and difficult to translate into concrete, measurable objectives.<sup>25</sup>

The Chinese government is trying to address these issues by creating more detailed and comprehensive regulations while also establishing a dialogue with industrial associations and organizations to publicize best practice for CSR.<sup>26</sup> It is also encouraging the release of sustainability reports that will ultimately enhance the reputation of the Chinese companies thus creating incentives for greater compliance. The State-Owned Assets Supervision and Administration Commission is currently evaluating ways of including corporate social and environmental impact metrics in the assessment for corporate

<sup>23</sup> Irene Yuan Sun & Tang Xiaoyang, *Social Responsibility or Development Responsibility? What Is the Environmental Impact of Chinese Investments in Africa: What are its Drivers, and what are the Possibilities for Action*, CORNELL INT'L L. J. 49 (1) 3 (2016); Tina Butler, *Growing Pains and Growing Alliances: China, Timber and Africa*, MONGABAY (Apr. 20, 2005); May Tan-Mullins & Giles Mohan, *The Potential of Corporate Environmental Responsibility of Chinese State-owned Enterprises in Africa*, ENVIRONMENT, DEVELOPMENT AND SUSTAINABILITY 15(2) 265-284.

<sup>24</sup> Negusi Akilu, *Greening Africa-China Relations: African Agents Punching Below their Weight?*, INT'L J. CHINA AND INTERN'L RELATIONS 26 (2014); China Council for International Cooperation on Environment and Development: Investment, Trade, and Environment 326 (2011), <http://www.ccced.net/encciced/policyresearch/report/201205/PO20120529369994285106.pdf>.

<sup>25</sup> Bingyu Liu, *supra* note 7, at 30; Weng & Buckley, *supra* note 12.

<sup>26</sup> GoldenBees, *supra* note 10.

leaders' remuneration, and the government is in the process of building a comprehensive credit system for tracking companies' behavior and activities.<sup>27</sup> While improvements are obvious, CSR is not yet incorporated into a national strategy, and there is no comprehensive framework or policy mechanism for CSR in China and its companies operating abroad.<sup>28</sup>

Practical implementation of CSR will be difficult without either a change in the attitude of Chinese enterprises and government such that they become more willing to interfere in the host country political and legal systems or an improvement in the host country rules and implementation of social and environmental responsibility.

Overall, a system of shared information on best practice when dealing with Chinese financiers and contractors would help African BRI states. It is hard to negotiate alone, especially if there is limited negotiation capacity and little funding dedicated to the legal aspects of the contract administration. Countries from the Global North could share their insights in contract negotiations with African countries, following, for instance, initiatives such as the American-led Blue Dot

Network which is attempting to set international standards for large infrastructure projects.

However, to avoid the traditional paternalistic approach of the Global North toward the Global South, it would be even better to create a platform among African countries that would allow them to share their own best practices and experiences in dealing and negotiating with China. In China, given that the BRI is closely linked with Xi Jinping and the success of the Chinese paradigm of development that places economic development first, projects must now start to balance economics with social and environmental responsibilities. The central government rules on CSR need to be specific and increasingly mandatory and should be accompanied by appropriate sanctions for underperforming companies. For China, the failure to address environmental and social impacts may determine the success or failure of BRI projects in the future.

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<sup>27</sup> Bingyu Liu, *supra* note 7, at 19; Meng Liu, *supra* note 7; Evelyn Cheng, *China is building a 'comprehensive system' for tracking companies' activities*, CNBC (Sept 3, 2019),

<https://www.cnbc.com/2019/09/04/china-plans-for-corporate-social-credit-system-eu-sinolytics-report.html>.

<sup>28</sup> LU, *supra* note 4.