Confronting Kremlin and Communist Corruption

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Introduction

I wish to thank Chairman Cardin, Co-Chairman Cohen, and the members of the Helsinki Commission for the opportunity to speak at today’s hearing. The commission has worked tirelessly to support U.S. economic and military security, combat corruption, and ensure the protection of human rights around the world. The commission also understands that ensuring our national security requires us to address the emerging risks posed by kleptocratic and authoritarian regimes. Refocusing on the foundations of strong democratic governance to address these threats is urgently needed.

The commission has recognized that strengthening our defenses against authoritarian threats starts with strengthening our own defenses. Key elements of the Counter-Kleptocracy Act are now moving forward as part of the National Defense Authorization Act. If enacted, this legislation will substantially strengthen America’s commitment to combating foreign corruption. The act includes language to allow for the prosecution of foreign officials demanding bribes from American businesses. It would close U.S. immigration and money laundering loopholes exploited by kleptocrats. It would call out human rights abusers and advance efforts to document the amount of money stolen by kleptocrats. It would strengthen the U.S. commitment to transparency, enforcement, and accountability. Congress and the Biden administration should work together to advance these sound policies.

Today, the United States faces growing aggression from kleptocrats and authoritarians who seek to erode open, rules-based systems of government in favor of closed, totalitarian regimes. Chief among these threats is China.1 The Chinese Communist Party (CCP) is seeking to rewrite global norms and rules of engagement with many, if not most, developing nations. Its primary vehicle to achieve this “reframing” of global engagement is its infrastructure investment monolith, the Belt and Road Initiative (BRI). However, the BRI is much more than an infrastructure program. It is a “geopolitical enterprise” and the primary vehicle through which China seeks to redefine its political and economic engagement with much of the world.2

Where the BRI goes, corruption follows. The initiative deliberately favors opacity and encourages corruption while justifying both in terms of “non-interference” in the domestic politics of BRI partner states. The infrastructure projects that grow out of this flawed process often prove to have minimal economic value while saddling partner states with massive debt. The United States can and should promote a more effective model of infrastructure development that brings shared prosperity and better governance to our partners.

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Contours of the BRI

Now recognized in China’s constitution as an initiative of lasting importance, the BRI could, in theory, help close the global infrastructure gap, providing much-needed ports, railways, bridges, roads, and other critical infrastructure capacity throughout the developing world. It has the potential to transform lives and economies, but the BRI is unlikely to fulfill this lofty vision. Rather, it appears to be headed in a very different direction, principally as a tool of China’s aggressive global expansion — one that is creating long-term dependency on Beijing. These debt dependencies have been made more acute by the COVID-19-induced economic crisis and its outsized impact on countries with high (and often hidden) levels of debt exposure to China, further exacerbating a trend of BRI-induced debt distress.

Consisting of opaque loans and deal terms, bribes, political influence, the imposition of Chinese technology and labor, and increasingly unsustainable levels of debt, the BRI’s operating model has created risks for recipient countries and pathways for the CCP’s long-term influence across economic, political, and social systems, especially in low- and middle-income countries.

New data tracking BRI investments and other Chinese investments abroad since 2000 largely bear out the reported frequency of corruption and governance challenges in BRI projects. Since its official launch in 2013, 35 percent of BRI projects have struggled with challenges related to corruption, labor violations, or environmental pollution, while only 21 percent of the Chinese government’s non-BRI infrastructure project portfolio has encountered these issues.

Detailed case studies of BRI projects in Malaysia and Kenya (see appendix) demonstrate the consequences of China’s failure to engage in open and transparent conduct. In Malaysia, massive BRI corruption has not only generated significant anti-Chinese sentiment, but also led voters to oust the incumbent prime minister and his political party — something unprecedented in Malaysia’s six-plus decades of independence. Kenya, meanwhile, is prosecuting Kenyan and Chinese officials and facing unmanageable debt resulting from a railway project that went massively over budget and was never completed. This calamity was the result of implausible expectations, opaque contracts, and a closed bidding process.

While corrupt practices may take root and proliferate more easily in countries that already suffer from weak governance and high levels of corruption, this does not adequately explain why

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corruption is so prevalent in the BRI. Rather, it is the CCP’s formal policy of “non-interference” with BRI recipient governments that sets the stage for corruption on a significant scale.

China claims to take a hands-off policy when it comes to engaging with recipient countries, pledging to stay out of their internal affairs. This so-called policy of non-interference is meant to replace the “conditionality” that often accompanies loans and guarantees from the United States and other countries and institutions that provide development assistance. Conditionality might include considerations for human rights, labor provisions, environmental considerations, transparency in procurement, anti-corruption policies, and other risk mitigation steps that a multilateral institution or a government might find useful to mitigate risk and ensure the successful implementation of an infrastructure project.

China rejects these elements of conditionality not because of a lack of exposure to them, but because of ample exposure. Indeed, the BRI demonstrates China’s readiness to defy prevailing international norms when doing so suits Beijing.

The real objectives behind China’s deliberate “high-risk, high-reward” investment strategy in developing economies are long-term political and economic fealty to the CCP as well as military advantages. China pursues these goals by cultivating high levels of indebtedness and co-opting local leaders who have received enough in personal payments and deal sweeteners to avoid holding Beijing accountable. Slipping in under the guise of “non-interference” allows for a competing system of investment “norms” that works to erode decades-long global efforts to combat corruption and promote good governance in global infrastructure development.

China funds BRI investments through its ample foreign currency reserves. China’s trade surplus with the United States has provided much of the foreign reserves required to support the dollar-driven expansion of Chinese loans and financing through Chinese financial institutions. Beijing also makes use of excess capacity within its state-owned enterprises (SOEs) in the construction sector by creating new markets abroad. In less than a decade, the BRI has changed the contours of the global development agenda, moving developing economies away from more transparent multilateral engagement and toward opaque bilateral deals that favor Chinese banks, financiers, technology, workers, and materials.

In addition to providing an outlet for excess Chinese domestic “capacity,” the BRI has also provided new pathways to structure debt in countries that already maintain high exposure rates

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This results in an incomplete picture of true levels of debt exposure. Since 2013, China has steadily shifted its financial support away from loans to sovereigns, instead favoring loans to foreign state-owned companies, state-owned banks, special purpose vehicles, joint ventures, and private-sector entities within recipient countries.9 Shifting away from loans tied directly to governments allows those liabilities to be treated as “off the books,” raising concerns that recipient countries are underreporting their total debt to China.10

While countries may improve balance sheets by keeping that debt off the official radar, it appears that the vast majority of these “off-the-book” deals are either formally or informally backed by some form of host government guarantee, thus distorting the true levels of indebtedness and exposure to China.11

The World Bank estimated in 2020 that approximately $500 billion was invested in BRI projects in 50 developing countries between 2013 and 2018.12 William and Mary’s AidData project reports that more than 40 countries now have levels of public debt exposure to China in excess of 10 percent of their GDP.13 AidData estimates that, on average, affected governments “are underreporting their actual and potential repayment obligations to China by an amount that is equivalent to 5.8 percent of their GDP. Collectively, these underreported debts are worth approximately $385 billion.”14

The widespread economic slowdown brought on by COVID-19 is exacerbating unsustainable debt burdens on countries that were already hard-pressed to repay Beijing.

A Clean BRI?

Not surprisingly, it has been difficult to glean sufficient detail on many BRI projects. The initiative is opaque by design. However, more data and insights are now becoming available, giving us a clearer view into the scale and scope of corruption challenges and indebtedness to China, and raising public awareness of Beijing’s questionable practices.

As discussed, the transactional conditions China prefers — closed bidding processes, non-transparent contracts, and a commitment to non-interference —frequently contribute to corrupt outcomes. Beijing seems to recognize the negative optics. In April 2019, China began to acknowledge that the BRI is facing significant governance and corruption risks. Chinese leader Xi Jinping called for launching a “Clean BRI,” or a “Silk Road of Integrity,” which, among other

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9 Ibid., page 44.
10 Ibid., pages 51–54.
11 Ibid., pages 44–45.
14 Ibid., page 3.
commitments, would seek to control corruption and increase transparency. The rhetoric of a “Clean BRI” amounts to a substantial departure from practices summarized by the president of China’s Export-Import Bank in 2007: “We have a saying: If the water is too clear, you don’t catch any fish.”

While Xi’s vision of a “Clean BRI” at least pays lip service to transparency and anti-corruption norms, there is little to suggest China is committed to it. During a December 2018 summit of the Forum on China-Africa Cooperation, Xi announced only a few modest initiatives to combat corruption, including the training of 100 local officials in recipient countries, along with plans for audits of certain SOEs. It is difficult to see how such audits of state-controlled organizations in an opaque environment can be effective. Similarly, it is unclear how additional local anti-corruption officials would have been sufficient to stem the corrupt practices uncovered in Kenya and Malaysia, for instance, where Beijing’s representatives directly encouraged corruption at the highest levels.

If BRI-related corruption is systemic and structural, then much deeper reforms are necessary. Such reforms would necessitate a complete review of contractual requirements and new enforcement mechanisms for Chinese companies operating abroad — none of which currently exist. Of course, it is doubtful that Beijing or many of its partners truly want a BRI free of corruption. However, this offers an opening for the United States and its partners to put forward a different model.

What Is the Path Forward for the U.S.?

Chinese-driven corruption under the BRI and elsewhere has created strategic advantages for Beijing, increasingly a development partner of choice for many countries. Unmet infrastructure needs across the developing world are immense, and the BRI often offers easy money to address those needs. However, recipient governments are increasingly waking up to the risks of China’s model, and a window exists to work with governments seeking alternatives.

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The United States has an opportunity to differentiate itself, but it needs to move quickly. Developing a more transparent and effective approach to infrastructure investment would be no small feat. Yet, by taking on this challenge, particularly in the wake of COVID-19, the United States and its partners can provide BRI recipients with an alternative to dependence on Beijing. The United States and its allies can help these countries meet their infrastructure development goals while creating more transparency and accountability and bringing real value to people in need.

The passage of the 2018 BUILD Act and the subsequent establishment of the International Development Finance Corporation sent an important signal of political commitment to expanding the U.S. role in infrastructure development.

The BUILD Act made two important changes to Washington’s model for encouraging infrastructure development: First, the law allows the U.S. government to make equity investments in foreign projects, which gives the United States skin in the game; and secondly, the act calls for heavy reliance on private-sector partners for infusions of capital. Ultimately, private institutional capital may be needed to address the substantial global infrastructure development gap. When proper inducements for greater market engagement are identified, including the mitigation of governance risks, such investments are more likely to follow.

The United States can take important steps to help move the playing field toward better, non-BRI alternatives:

- Demonstrate anti-corruption leadership by closing our loopholes, strengthening our laws, and increasing our enforcement actions to counter foreign corruption. With the support of the Helsinki Commission, important counter-kleptocracy legislation is now moving forward as part of the National Defense Authorization Act for Fiscal Year 2022.²¹ Composed of seven anti-corruption bills, the Counter Kleptocracy Act²² is the most comprehensive set of measures put forward to combat foreign corruption by closing existing money laundering, immigration, and enforcement loopholes that limit the ability of kleptocrats to use our systems to their advantage. This legislation furthers our historic commitment to robust anti-corruption legal and regulatory frameworks.

- Double down on investment strategies that offer clean alternatives to the BRI. The United States is now engaging with its allies through initiatives such as the Build Back Better

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World initiative, launched under the G7\textsuperscript{23} and the Blue Dot Network.\textsuperscript{24} These efforts should be fully supported and expanded to include more partner nations and increased funding from both public and private investors, and should be rooted in strong global best practices to address corruption risks.

- Increase efforts to educate citizens and support the work of civil society organizations and journalists who bravely report on corruption risks. We need a full-fledged, whole-of-government effort to combat misinformation and disinformation campaigns that shroud the corrupt practices of China and other regimes across developing economies. Authoritarian “gaslighting” obfuscates the actions, objectives, and outcomes of opaque deals.\textsuperscript{25} It is time to call out this behavior and help countries understand and respond to the real risks of doing business with Beijing.

- Promote a U.S.-driven global dialogue and foreign-investment strategy that pushes anti-corruption and transparency to the top of the agenda. The Summit for Democracy could be utilized as a venue to create new, impactful commitments to reinforce global anti-corruption standards and a stronger narrative on partnerships that reinforce democratic norms.

- Pivot critical supply chains out of China and toward allied countries. COVID-19 has laid bare the fact that any dependencies on regimes such as the CCP may put us at risk when global shocks affect critical supply chains. “Ally-shoring” could reduce dependencies on China for critical materials and supplies and, over time, could help bring production, jobs, and long-term economic security much closer to home.\textsuperscript{26} Through ally-shoring we can revitalize and extend our own networks of partners and allies, further reinforce democratic norms and anti-corruption standards, and provide a backstop to the corrosive effects of the BRI.

- Increase pressure on China to prosecute the foreign corrupt practices of its SOEs, private firms, and nationals. While China has engaged in a sweeping (albeit heavily politicized) domestic anti-corruption campaign, Beijing has done little to extend clean practices abroad. Washington should put more pressure on China to live up to its narrative of a “Clean BRI.”

\textsuperscript{23} The White House, Fact Sheet, “President Biden and G7 Leaders Launch Build Back Better World (B3W) Partnership,” June 12, 2021. (https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/12/fact-sheet-president-biden-and-g7-leaders-launch-build-back-better-world-b3w-partnership)
• Support BRI recipient countries in the impartial adjudication of corruption disputes, including disputes over stolen asset recovery, and provide technical support to help understand and mitigate risks of doing business with China.

Renewed public trust will be the real dividend of these efforts, as citizens around the world will reap the benefits of high-quality infrastructure supported by the United States and its partners. The United States can and should lead this charge. We and our partners should strongly encourage Beijing to join us in delivering clean global infrastructure, even if that feels unlikely in the present moment. But there is no reason to wait. The United States should seize the opportunity now, offering a better way forward.

Case Study on Corruption in the BRI: Kenya

In 2014, Kenya became one of the first countries to join the BRI, when Chinese Premier Li Keqiang signed an agreement with the Kenyan government to build the Mombasa-Nairobi Standard Gauge Railway (SGR).27 The BRI’s flagship project in Kenya, the SGR was the first phase of a line that was eventually to connect to similar railways in Uganda, Rwanda, and South Sudan. The overall project was intended to be integrated and multilateral. However, each country individually negotiated its own terms of financing for its respective section.

The SGR in Kenya involved the construction of over 300 miles of fresh track to connect Nairobi to Mombasa, Kenya’s second-largest city and the busiest port in East Africa. Mombasa serves as the entry-point for a large proportion of goods entering not only Kenya but also large areas across Uganda, South Sudan, Rwanda, Burundi, and the Democratic Republic of Congo.28

The SGR was designed to cut travel time between these destinations while at the same time reducing overall costs and increasing logistical efficiency. Economically, the success of the railway line depended upon robust uptake of its freight service by private-sector importers and exporters.29

Prior to settling on the chosen SGR plan, Kenya rejected less expensive alternatives. A study by the World Bank,30 for example, identified several viable options, including the rehabilitation or upgrading of the colonial-era railway networks in Eastern Africa. The most expensive option detailed in the study was the new SGR line along a new right-of-way. The price tag included the high costs of land acquisition and of building new railway stations and other structures from scratch. Undeterred, Kenya chose the most expensive track.

Kenya was the first East African country to secure funding from China. Construction commenced in 2014, making it an early BRI project. To optimize speed, China and Kenya

29 Ibid.
utilized a “government-to-government” procurement model, which made the SGR exempt from local procurement laws. The terms and conditions of China’s financing meant the project was not subject to competitive bidding or transparency reporting requirements for government tenders, as would otherwise be required.

At a cost of $3.8 billion (excluding land acquisition), the first phase of the SGR was Kenya’s most expensive individual infrastructure project in its post-independence history. Costs were projected to double if the state pursued plans to extend the SGR to Kenya’s border with Uganda. The Mombasa-Nairobi line’s cost per kilometer (a standard metric for comparing rail infrastructure costs) was $5.6 million for the track alone — nearly three times the international standard and four times Kenya’s initial estimates.

The projected cost per kilometer was also unusually high compared to similar projects in other countries. For instance, Tanzania is building a railway of similar length, traversing similar terrain, at half the cost of the SGR (approximately $1.9 billion). In addition, the Tanzanian line is electric, giving it significant speed advantages over Kenya’s diesel-powered SGR. Tellingly, Tanzania had canceled an earlier contract with a Chinese contractor for that railway line after reports of corruption and irregularities surfaced. Following the cancelation, Tanzania utilized a competitive bidding process in which 15 contractors submitted bids, resulting in a Turkish firm undertaking the project at significant savings.

Looking back, the Kenyan government projections of the SGR’s profitability were wildly optimistic — a point the government’s own advisors made as early as 2009. Moreover, a World Bank study showed that the SGR project would need to transport 20 to 55 million tons of cargo per year to break even — assuming a cost per kilometer around half of that which Kenya

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ultimately paid. In 2015, annual cargo throughput at the Port of Mombasa amounted to just 26 million tons. By 2018, that number rose to 31 million tons. Even with a strong growth trajectory, however, the SGR would still need to handle more than all of the cargo flowing through Mombasa’s port to avoid losing money.

As of 2018, the SGR was handling only 5 million tons of the freight shipped annually between Mombasa and Nairobi. This low number derives partly from the railroad’s competitive disadvantages compared with trucking, which provides point-to-point mobility (in other words, from port to final destination). SGR customers, by contrast, have to cover the additional cost of moving their cargo from an Inland Container Depot (ICD) along the railway line to its final destination. Shipping a container via the SGR costs roughly 50 percent more than over-road options. In addition, the SGR is facing major congestion at the Nairobi ICD. In its first year of operation, the SGR incurred losses of roughly $100 million.

In addition to low freight uptake, the SGR suffered from significant governance failures and corruption. While many instances of corruption have likely gone undetected, there is concrete evidence of substantial corruption on both the Kenyan and Chinese sides. For example, the Kenyan public prosecutor indicted several high-level officials on corruption and fraud charges, including both the chairman of Kenya’s National Lands Commission, a constitutional body overseeing the registration and transfer of land assets in the country, and the managing director of Kenya Railways Corporation, a government-owned company in charge of operating rail infrastructure nationwide. These officials allegedly conspired on a $2 million fraudulent land-acquisition scheme wherein they illegally acquired government-owned land and then sold it under a compensation process meant to repay those whose land was in the new railway’s path.

In 2018, Kenyan authorities also arrested seven officials from China’s Road and Bridge Corporation in connection with bribery attempts meant to derail ongoing investigations into SGR

41 Philip Mwakio, “Port expected to process 31 million tons of cargo this year,” Standard Digital (Kenya), November 12, 2018. 
43 Ibid. 
44 “Is Nairobi’s container depot main cause of import cargo pile-up?” The East African (Kenya), June 11, 2018. 
corruption. Additionally, in early 2019, Kenya’s Ethics and Anti-Corruption Commission suspended compensation for SGR land acquisitions in light of widespread accusations that National Lands Commission officials were demanding kickbacks to facilitate legitimate compensation payouts to landowners.

General project opacity has also raised some troubling questions. Leaked documents revealed that the railway’s Chinese operator imposed a hefty management fee structure that guaranteed payments irrespective of delays in the launch of railway operations and gave the operator priority access to railway revenue to service management fees. A leaked report from the Kenyan Auditor General’s office claimed that Mombasa Port assets were used as collateral to finance the SGR, with the contract waiving Kenya’s sovereign immunity. After Kenyan media jumped on the issue, the Auditor General’s Office distanced itself from the leaked document. China’s Foreign Ministry spokesperson also denied the reports. However, after the highly publicized Sri Lankan default on its Port of Hambantota, the possibility that national assets might be at risk generated considerable anxiety within Kenya. In 2018, Moody’s listed Kenya as one of the countries most vulnerable to losing strategic assets to Chinese creditors.

In late 2018, the International Monetary Fund (IMF) officially revised its evaluation of Kenya’s financial risk profile, raising Kenya’s risk of default on debt repayment from “low” to “moderate.”

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52 David Mwere, “China may take Mombasa port over Sh227bn SGR debt: Ouko,” Daily Nation (Kenya), December 20, 2018. (https://mobile.nation.co.ke/news/Chinese-may-take-Mombasa-Port--Ouko/1950946-4902162-item-1-cv5re2z/nation.co.ke)
54 Sri Lanka’s Port Hambantota has become a focal point for debate about the BRI. When the country could not pay back its debt, Beijing asserted ownership over the port and other strategically important assets. See: Elaine K. Dezenski, “Below the Belt and Road: Corruption and Illicit Dealings in China’s Global Infrastructure,” Foundation for Defense of Democracies, May 6, 2020. (https://www.fdd.org/analysis/2020/05/04/below-the-belt-and-road)
rise in debt levels and deterioration of debt affordability.”57 The IMF also ended Kenya’s access to a $1.5 billion credit facility that was intended to be a financial buffer for the government.58 These developments drive up the cost of future financing, impinging the country’s ability to meet future infrastructure needs.

Plans to expand the SGR in Kenya, and in East Africa more broadly, now find themselves on shaky ground. In 2019, China withheld further funding that would have gone toward extending Kenya’s SGR line from central Kenya to the border with Uganda.59 Moreover, with SGR operations failing to raise sufficient revenue to break even, Kenya may be unable to repay its existing SGR debt, as the five-year grace period on its 2014 loan has expired.60

In the end, China and Kenya are now left with infrastructure that is not cost effective and fails to achieve its intended purpose of connecting Africa’s eastern seaboard to the land-locked countries of the interior and to other regional rail lines.

Case Study: Malaysia

Like Kenya, Malaysia was an early recipient of significant BRI funds. Southeast Asian countries, located in China’s backyard, are among the largest recipients of BRI funds, with extensive rail, sea, and other infrastructure projects in progress or planned. Malaysia alone had signed nearly $100 billion worth of deals with China as of 2018,61 matching China’s BRI investment in all of Africa. China’s investments in Malaysia include projects to enhance tourism and commercial real estate development,62 alongside more traditional investments in railways, ports, and industrial hubs.

BRI projects in Malaysia are immense. The East Coast Rail Line, for instance, is an $11 billion, 600-kilometer railway currently under construction by the state-owned Chinese Communications Construction Company and financed by the Export-Import Bank of China. This railway connects

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61 Jinny Yan, “The BRI in Southeast Asia” in “China’s Belt and Road Initiative (BRI) and Southeast Asia,” London School of Economics and Political Science and CIMB ASEAN Research Institute, October 2018, page 8. (http://www.lse.ac.uk/ideas/Assets/Documents/reports/LSE-IDEAS-China-SEA-BRI.pdf)
a major port near Kuala Lumpur to areas on the eastern coast of the Malay Peninsula.\(^{63}\) Another major project is the Melaka Gateway, a $7 billion maritime and tourist hub on Malaysia’s west coast, which currently enjoys significant Chinese investment.\(^{64}\) Other projects include industrial parks, port expansions, high-speed railway lines, artificial-island construction, and mixed-use developments.

Malaysia’s ambitious infrastructure push, however, has faltered because of widespread corruption, highlighted by the massive 1Malaysia Development Berhad (1MDB) scandal. 1MDB is Malaysia’s national development fund, launched by former Prime Minister Najib Razak as an investment vehicle to attract foreign capital for strategic projects. Rather than functioning to meet the needs of the rapidly growing country, the fund has been used for money laundering and misappropriation of state funds. Between $3.5 billion\(^{65}\) and $4.5 billion\(^{66}\) was siphoned from 1MDB over a six-year period, making the fund insolvent by 2018.\(^{67}\) As much as $1 billion found its way into Najib’s bank accounts.\(^{68}\) In fact, much of the money was embezzled for the personal benefit of a small clique close to Najib. Jho Low, a central figure in the scandal, bought a $250 million, 300-foot superyacht, while gifting a $4 million diamond necklace to the supermodel Miranda Kerr and a $3 million Picasso to actor Leonardo DiCaprio.\(^{69}\) A raid on Najib’s house yielded approximately $250 million worth of luxury goods, including 12,000 pieces of jewelry (including 14 tiaras), hundreds of watches, 500 handbags, and nearly $30 million in cash in 26 different currencies.\(^{70}\)

Malaysia’s kleptocracy, while homegrown, was facilitated in part by China, often using BRI vehicles. When the 1MDB fund faced insolvency in 2016, Najib went to Beijing to increase

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\(^{64}\) Ching Yee Choo, “Malaysia and China ink $7.3bn Melaka Gateway project,” *Nikkei Asia* (Japan), September 3, 2016. (https://asia.nikkei.com/Economy/Malaysia-and-China-ink-7.3bn-Melaka-Gateway-project)


Chinese investment in Malaysia. Chinese SOEs invested heavily in 1MDB to prop it up while gaining leverage over strategic real estate and energy projects in the country. For example, China General Nuclear Power Corp bought 100 percent of Malaysia’s second-largest power producer, Edra Global Energy Bhd, which belonged to 1MDB’s portfolio. The $2.3 billion cash deal allowed 1MDB to pay off its maturing debt and gave China greater leverage over Kuala Lumpur.

Senior Malaysian government officials also claimed that in exchange for helping to mitigate the 1MDB scandal, China was offered lucrative contracts for various infrastructure projects — contracts that China signed under the BRI. The value of some of those contracts was inflated, with financing provided at “above market profitability” to generate excess cash to settle 1MDB’s rising debts.

According to recent reports, Beijing offered to protect 1MDB from international investigations into the fund’s financial mismanagement. In early 2019, The Wall Street Journal claimed that China offered to wield its influence to halt investigations in the United States and elsewhere in exchange for Malaysia spending $16 billion on the East Coast Rail Link — nearly two times the railway’s projected cost. Shortly after the meeting, Malaysia agreed to $34 billion in BRI deals with China for rail, pipeline, and other projects, including the inflated East Coast Rail Link. The Chinese negotiators, allegedly acting on instructions from Xi, reportedly also offered to help Najib identify Malaysian sources who were cooperating with journalists, by using Chinese government surveillance on reporters in the Hong Kong bureau of The Wall Street Journal.

The 1MDB scandal, first revealed in 2015, upended Malaysia’s domestic politics. Then-opposition leader and current Prime Minister Mahathir Mohamad used the burgeoning scandal to discredit Najib’s government in the lead-up to Malaysia’s 2018 election, exploiting China’s

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73 The transfer in ownership had to be exempted from local laws that limited foreign ownership in Malaysia’s power sector to 49 percent. “UPDATE 2-Malaysia's struggling 1MDB sells power assets to Chinese firm for $2.3 bln,” Reuters, November 23, 2015. (https://www.reuters.com/article/malaysia-1mdb-china/update-2-malaysia-striking-1mdb-sells-power-assets-to-chinese-firm-for-2-3-bln-idUSL3N13I2SX20151123)
77 Ibid.
involvement with 1MDB as a potent political weapon.\(^7\) Mahathir’s victory marked the first time an opposition candidate defeated the ruling coalition since the country’s independence, and it was largely seen as a response to excessive corruption in Najib’s administration.\(^8\)

After Mahathir became prime minister in 2018, Malaysia’s approach to China-backed projects appears to have changed significantly. Previous contracts and projects are now scrutinized under a more critical lens, and government investigations continue to reveal evidence of corruption. As a consequence, some BRI projects have been delayed, while others have been renegotiated or canceled.\(^9\) In 2018, Malaysia canceled two 1MDB oil and gas pipeline deals that China’s state-owned China Petroleum Pipeline Bureau intended to construct at a cost of over $1 billion apiece. At the time of cancelation, China Petroleum Pipeline had been paid nearly 90 percent of the contract’s value despite having completed only 13 percent of the work,\(^10\) leading Malaysian authorities to seize $240 million from bank accounts belonging to the company.\(^11\)

The East Coast Rail Link, Malaysia’s flagship section of the Pan-Asian Railway Network, has unsurprisingly encountered its own challenges. The $16 billion mega-deal negotiated under Najib was canceled by the new government in light of cost overruns (costs ballooned to nearly $20 billion), corruption concerns, and a general lack of transparency — including a closed bidding process that failed to consider more affordable options from local contractors.\(^12\) Eventually, the project was revived, with Malaysia renegotiating the railway’s cost down to $11 billion.\(^13\)

It remains to be seen how the East Coast Rail Link, and the Malaysian-Chinese BRI partnership more generally, will fare moving forward. However, neither China nor Malaysia is happy thus far. If Beijing’s goal was regional political influence, it has instead provoked anti-China

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\(^8\) Stephania Palma, “Malaysia finance minister suggests China connection to 1MDB,” Financial Times (UK), June 5, 2018. (https://www.ft.com/content/40bb3dcd-68a6-11e8-8cf3-0c230fa67ae)


sentiment. If Beijing hoped to establish a viable regional railway system, the Malaysian component remains in doubt. If China simply wished to lend large amounts of money on favorable terms, those terms have since been renegotiated and the profits lost. Meanwhile, Malaysia has flipped from a reliable ally to a strategically important neighbor that is now skeptical about — or even hostile to — China’s regional ambitions.