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PERSPECTIVE

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Deepening of Malaysia's Economic Ties to China: What Are the Implications?

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EXECUTIVE SUMMARY

- Fourteen MOUs and agreements officially valued at RM143.64 billion were signed in Beijing during Malaysian Prime Minister Najib Razak's visit to China.
- The participation of companies from China in three mega projects in Malaysia are likely to accelerate their implementation (East Coast Rail Line, Melaka Gateway project and Bandar Malaysia).
- Some components of the mega projects may hold some possible consequence for Malaysia's fiscal position in the future.
- Greenfield investments and initiatives to improve market access should prove beneficial even though the impact on the overall trade balance between Malaysia and China may be limited.

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INTRODUCTION

On 1 November 2016, Malaysian Prime Minister Najib Razak kicked-off his five-day official visit to China by presiding over the signing of 14 memoranda of understanding (MOUs) agreements worth RM143.64 billion (USD 34.4 billion). This is indeed a significant amount – equivalent to 12 percent of the size of the Malaysian economy.[1] For many, the event signifies a deepening of economic ties between Malaysia and China.

But what are these deals? Are they associated with foreign direct investments from China? And how will they affect the Malaysian economy?

This Perspective examines the nature of these 14 MOUs and agreements as well as their implications for the Malaysian economy. Though many of these were worked out months before being showcased in Beijing in the Prime Minister's presence, an analysis of these deals provides some insight into how recent investments and projects from China are likely to affect the Malaysian economy.[2]

SETTING THE SCENE: TRADE & INVESTMENT

Trade is without doubt an important driver of growth for both Malaysia and China. How important China is to Malaysia as a trading partner is evidenced in the fact that China is Malaysia's most important trading partner in terms of total trade (imports and exports), and that its share of Malaysia's exports is estimated to be around 15.5 percent in 2016. Furthermore, China's share of Malaysia's total trade has risen rapidly over the years, especially after the country's accession into the WTO in 2001 (*Figure 1).*

As a destination for Malaysia's exports, China ranks second (to Singapore), accounting for 10 percent of Malaysia's total exports in 2016 *(Figure 2)*. However, as a source of imports, China tops the list – accounting for 20 percent of Malaysia's total imports *(Figure 3*). An important feature of Malaysia's trade with China is that it is not a balanced one – Malaysia imports more from China than it exports to China, resulting in an estimated deficit of RM24 billion in 2016 (*Figure 4*). Thus, economically, China gains more from trade between the two countries.

[1] Measured in terms of gross domestic product (GDP).
[2] An interesting angle not examined in this article is the choice of partners in China's FDI in Malaysia. For this, see: Lim, Guanie. (2015). "China's Investments in Malaysia: Choosing the "Right" Partner", International Journal of China Studies, Vol.6, No.1, pp.1-30.

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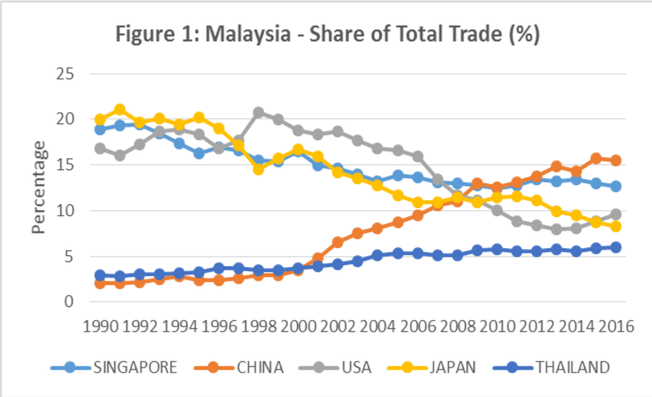

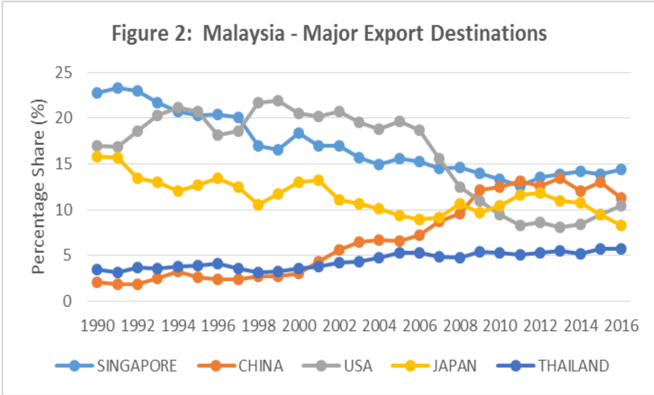

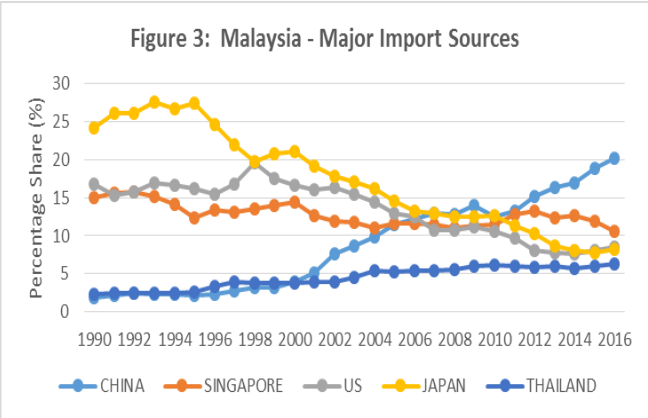

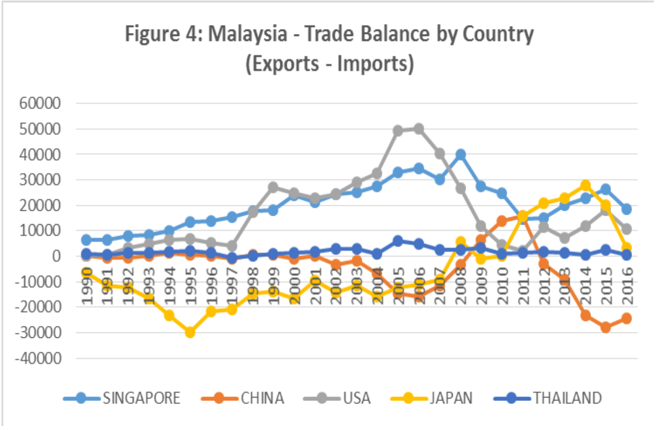

Source: Ministry of Finance

In terms of trade structure, Malaysia's exports to China is less diversified than its imports from China (*Table 1*). Close to a third of Malaysia's exports to China comprises integrated circuits and computers. These products are also the top products imported from China. Thus, there is a fair amount of intra-industry trade between the two countries in these industries. Recent research by Professor Tham Siew Yean and her colleagues has found that Malaysia has been losing its competitiveness in these industries' exports to the point of exiting from some products altogether.[3] Trade with China in these industries has also not resulted in upgrading. Aside from integrated circuits and computers, a significant proportion of Malaysia's exports to China consists of primary commodities.

[3] Tham, Siew-Yean, Andrew Jia Yi Kam and Nor Izzatina. (2016). "Moving Up the Value Chain in ICT: ASEAN Trade with China", Journal of Contemporary Asia, Vol.46, No.4, 680-699.

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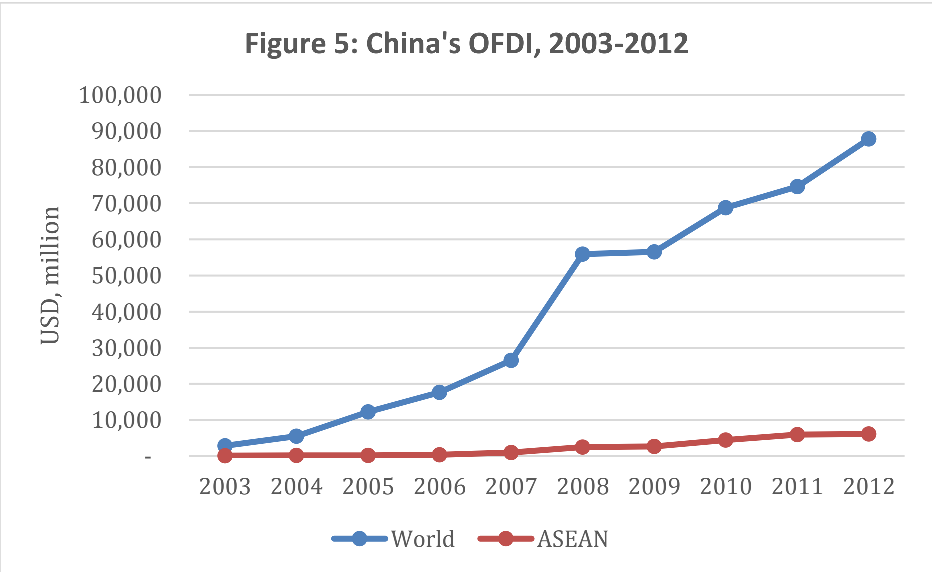
Table 1: Key Products in Malaysia-China Trade, 2014

Exports to China		Imports from China	
Product	**% Share**	**Product**	**% Share**
Integrated Circuits	26.0	Integrated Circuits	13.0
Computers	6.1	Computers	3.8
Palm Oil	6.0	Broadcasting Equipment	2.4
Asphalt Mixtures	4.4	Telephones	2.2
Refined Petroleum	3.9	Office Machine Parts	2.2
Petroleum Gas	3.8	Broadcasting Accessories	1.8
Semiconductor Devices	3.7	Refined petroleum	1.8
Scrap Copper	2.1	Aluminium Bars	1.4
Rubber	1.9	Raw Nickel	1.4
Compounded Unvulcanised Rubber	1.9	Printed Circuit Boards	1.4

Source: Data are at 4-digit level from the Observatory of Economic Complexity

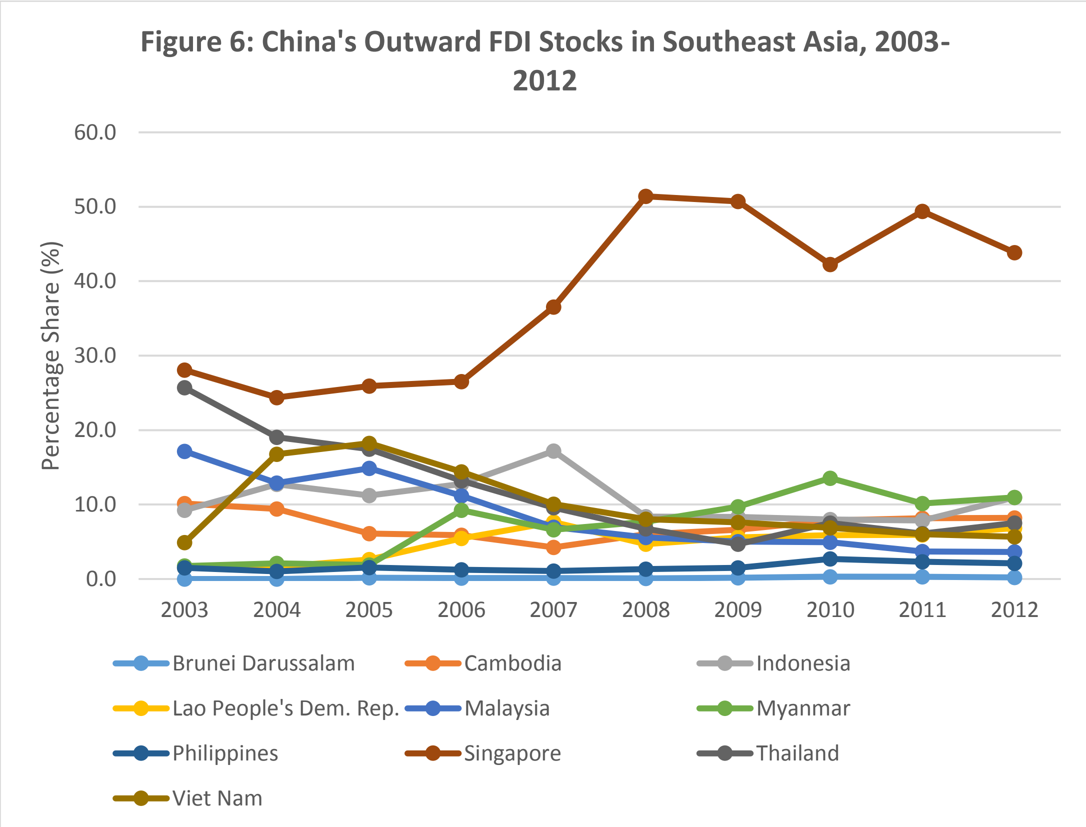
Globally, China's outward foreign direct investment (OFDI) has increased rapidly over the period 2003-2012 (*Figure 5*).[4] Regionally, Southeast Asia's share of China's total OFDI has also increased during this period, though this has remained below 8 percent. In terms of China's OFDI stock in Southeast Asian countries, Malaysia's share in the region has declined from 17.1 percent in 2003 to 3.6 percent in 2012 (*Figure 6*). Thus, historically – at least up to 2012 – Malaysia has become less important as a destination for China's OFDI in this region.



Source: UNCTAD

[4] The latest figures available on outward FDI from the database of the United Nations Conference on Trade and Development (UNCTAD) are for the year 2012.

Data from the Malaysian Investment Development Authority (MIDA) for the period 2012-2015 show that China is the fourth most important source of FDI in the manufacturing sector during this period 2012-2015 (*Table 2*).[5] Statistics from MIDA also indicate that China is likely to become a more important source of manufacturing FDI in 2016.[6] China's FDI in services is also likely to remain significant, based on investments reported in the media. Large flows of China's FDI in services took place around 2013 and focused primarily on real estate development in Johor (see *Appendix*). The current wave of China's FDI in services appears to be concentrated on real estate development in Kuala Lumpur and Melaka. Some of these are related to the agreements signed during Najib's visit to Beijing in November 2016.



Source: UNCTAD

[5] There are several limitations in the FDI approval data. First, actual investments may differ from (and are often less than) approved investments. Second, some investments involving mergers and acquisitions may not be captured in the data. Third, investments in services may not be fully captured in the data.
[6] Source: http://www.mida.gov.my/home/projects-approved-by-major-country,-january---august-2016-and-2015/posts/

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Table 2: Malaysia Foreign Investment in Approved Manufacturing Projects, 2012-2015 (RM, million)

	2012	**2013**	**2014**	**2015**	**Total**
United States	296	6,321	1,350	4,150	12,117
Australia	150	167	213	255	785
China	1,978	3,018	4,752	1,872	11,620
Hong Kong	91	454	70	3,181	3,796
Indonesia	86	214	73	1	374
Japan	2,793	3,592	10,870	4,009	21,264
Germany	693	1,717	4,417	1,161	7,988
Netherlands	835	2,382	816	977	5,010
South Korea	1,637	5,479	1,549	1,353	10,018
Singapore	2,215	4,522	7,822	1,395	15,954
Taiwan	172	131	692	1,276	2,271
Others	9,975	2,540	6,969	2,312	21,796
Total	20,919	30,536	39,593	21,942	112,990

*Estimate; Source: MIDA

ECONOMIC IMPACT OF THE 14 DEALS

RM143.64 billion (USD 34.4 billion) – that is the estimated value of the 14 MoUs and agreements signed on the first day of Najib's visit to China. As there are no details on how this figure was arrived at, one can only make some rough estimate of the economic value of some of these deals based on details from the media including the press reports on related projects announced prior to Najib's visit to China.

Table 3 provides a summary of the value of projects associated with the 14 MOUs and agreements.[7] They beg the question what the economic impact of these deals and projects will be. The most important ones relate to infrastructure and commercial development, such as the East Coast Rail Line (ECRL), Bandar Malaysia and Melaka Gateway.

[7] In addition to these deals, a number of announcements were also made that may have significant economic impacts. These include efforts to increase exports of palm oil to China and additional flights (routes, destinations and frequencies) between Malaysia and China.

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Table 3: Investments Related to Recent China-Malaysia MOUs and Agreements

MOU / Agreement / Project	Nature	Value (RM, bil.)
1. Malaysia Rail Link Sdn Bhd, China Communication Construction Company Ltd & China Communications Construction Company (M) Sdn Bhd	Construction of East Coast Rail Link (estimated completion: 2022)	55.0
2. KAJ Development Sdn Bhd (51%) & Power-China International Group Limited (49%)	Construction and investment in Melaka Gateway Project (estimated completion: 2025) The Melaka Gateway Port will be built with the involvement of Yantian Port Group Co.Ltd, and Rizhao Port Group Co.Ltd. The port is expected to cost RM8 billion and to be completed by 2019.	30.0+
3. Bandar Malaysia Sdn Bhd & Greenland Holdings Group Overseas Investment Co Ltd	Announced as "Purchase of land and development thereon in Bandar Malaysia" and "highway construction program".	NA
4. Selat PD Sdn Bhd & CCCC Dredging (Group) Co Ltd.	No details on the project were released. Note: Bina Puri Holdings Bhd (50%) and China's CCCC Dredging (Group) Co Ltd (50%) is also involved in the Kuantan Waterfront Resort City (KWRC) project worth RM15 billion.	NA
5. State Government of Sarawak, Hebei Xinwuan Steel Group & MCC Overseas Ltd	Proposed development of steel plant in Samalaju Industrial Park (SIP) in Bintulu, Sarawak.	13.0
6. KAJ Development Sdn Bhd, Power China, Shenzhen Yantian Port & Rizhao Port	Memorandum of agreement for partnership collaboration on Melaka Gateway Port.	
7. IWH CREC Sdn Bhd and Industrial & Commercial Bank of China (ICBC)	Bandar Malaysia financial scheme. CREC is expected to build a RM9 bil regional centre in Bandar Malaysia (Note – IWH CREC is a 60:40 joint venture Iskandar Waterfront Holdings Bhd and China Railway Engineering Corp (CREC))	9.0
8. East Coast Economic Region Development Council (ECERDC) & Wuxi Suntech Power Co Ltd	Production base for crystalline silicon solar cells and module within the Malaysia-China Kuantan Industrial Park (MCKIP).	4.0
9. BHS Industries Bhd & China Nuclear Huaxing Construction Co Ltd (HXCC)	Pulp and paper mill using oil palm empty fruit bunches in the Green Technology Park in Pekan, Pahang. (estimated completion: 2017)	2.0
10. China Construction Bank (M) Bhd	To provide infrastructure financing. Banking licence issued by the Minister of Finance under the Financial Services Act 2013. (Initial paid-up capital of US$200mil)	NA
11. Yanming Resources Sdn Bhd & Fuzhou Xin Zibu Culture Communication Co Ltd	Growth and development of bird's nest market in China.	NA
12. Malaysia External Trade Development Corp (Matrade) & Alibaba.com	Memorandum of understanding Note: MATRADE has been collaborating with Alibaba since 2014 to enable Malaysia SMEs to trade using Alibaba's B2B platform.	NA
13. Royal Bird's Nest, Walet Company-International Private Ltd Co & Peking University	Research and development collaboration on the standardisation of edible bird's nest extract and medical properties for pharmaceutical drug discovery.	NA
14. Aladdin Group Sdn Bhd & Suzhou Lian Cheng Yihao Information Technology Co Ltd.	Memorandum of understanding Note: No information is available on the nature of the MOU. Aladdin group is building a global halal e-commerce platform. The Chinese halal food market is estimated to be worth USD6 billion.	0.126

Source: Author's compilation based on media reports. NA – not available.

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The ECRL is a 600km-line rail line that will link the Kuala Lumpur/Klang Valley region to the east coast of Peninsular Malaysia.[8] Expected to cost RM55 billion (USD 13.1 billion) to build, it will be financed by a 20-year loan from Export-Import (Exim) Bank of China. The Malaysian government considers the ECRL to be a crucial transportation infrastructure for the East Coast Economic Region (ECER) – a regional development initiative covering the states of Pahang, Terengganu, Kelantan and the District of Mersing in Johor.[9] The Prime Minister has stated that the ECRL is expected to add 1.5 percent to the GDP growth of the three states.[10] Whilst the project will improve connectivity between the eastern and western corridors of Peninsular Malaysia, the overall impact and financial feasibility of the project is uncertain.

Will the convenience associated with the use of the East Coast Expressway lead to an underutilization of the ECRL? Will new industrial parks such as the Malaysia-China Kuantan Industrial Park (MCKIP) generate sufficient traffic for ECRL? Furthermore, China's role in this project is not as investor (FDI) but more as contractor and financier which translates the project itself into an export of services from China to Malaysia more than anything else. The ECRL is clearly a large project – costing close to 8 percent of the country's current public debt. The government's fiscal position could be weakened if the project fails to generate sufficient returns to service and repay the debt incurred.

The second infrastructure project featured prominently during Najib's visit to China is the Melaka Gateway Project (MGP). The RM30 billion (USD7.2 billion) plus project has been described as a mixed development project comprising four islands – three to be reclaimed and one natural – each dedicated to a specific set of activities (port, industrial park, free trade zone and commercial/residential development). The project will entail some investment from China in the areas of port ownership and real estate development.

Port facilities will be built on two islands (3 and 4). The Melaka Gateway Port at Island 3 will be a liquid bulk terminal most likely for oil bound for China. The prospects of the multi-purpose port at Island 4 (Pulau Panjang) are uncertain given that the Melaka hinterland may be relatively limited.[11] Real estate and commercial development on Islands 1 and 2 is ambitious, and its success will likely depend on foreign buyers. This also has the advantage of being scaled back should demand prove to be weak. Overall, it is quite

[8] The project will be developed in three phases: Phase 1: Port Klang to the Integrated Transport Terminal (ITT), Gombak; Phase 2: ITT Gombak to Dungun; and Phase 3: Dungun to Tumpat.
[9] The ECER development involves five economic clusters spread across seven areas (nodes). The clusters are: (i) manufacturing (ii) oil, gas and petrochemicals (iii) tourism (iv) agribusiness (v) human capital development. The seven nodes are depicted at http://www.ecerdc.com.my/en/about-ecer/key-development-area-kda/.
[10] "Mind the gap: ECRL can close east-west coast economic divide, says Najib" New Straits Times, 28 November 2016.
[11] Melaka has a number of industrial parks served primarily by Port Klang. A new container port at Melaka may lack economies of scale.

possible that the Melaka Gateway Port will show itself to be the key and strategic element in China's investment in the MGP.

Bandar Malaysia is the third project that received significant coverage amongst the MOUs signed in China. The project is estimated to cost RM200 billion (USD48 billion) with the first phase (5-6 years) alone costing RM50-60 billion.[12] Significantly, Bandar Malaysia will also be the terminal point for the RM60 billion Kuala Lumpur-Singapore High-Speed Rail (HSR) expected to be completed by 2026.

Bandar Malaysia will be jointly developed Bandar Malaysia Sdn Bhd which is 40 percent owned by MOF Inc and the rest by a consortium jointly owned by Iskandar Waterfront Holdings Sdn Bhd (60 percent) and China Railway Engineering Corp (40 percent). Another company from China – Greenland Holdings Group Overseas Investment Co Ltd – is involved in the project as well.

Two of the other MOUs signed are also related to the financing of the Bandar Malaysia project. The first is the Bandar Malaysia Financial Scheme involving IWH CREC Sdn Bhd and Industrial and Commercial Bank of China (ICBC). The second is the granting of a banking licence for China Construction Bank (M) Bhd which is involved in the consortium fund for the project (Bandar Malaysia Fund). Bandar Malaysia will clearly alter the urban landscape in Kuala Lumpur and the Greater Klang Valley Area. These developments are likely to increase investments from China in the areas of real estate development and banking – and possibly make Kuala Lumpur a new regional financial hub for Chinese investments in the region.

Smaller investments and collaborations that were also signed in China include deals on three manufacturing projects with a combined investment value of RM19 billion (USD4.5 billion). These are significant foreign greenfield investments. The manufacturing investments in Kuantan and Pekan relate to green technology and industries – an area which Malaysia is eager to venture into. One of the key benefits from the steel plant in Samalaju Industrial Park will be the utilization of the excess electricity generation capacity at the Bakun Dam.

Finally, four of the MOUs are aimed at gaining greater access to the Chinese market in two areas, namely, bird's nest and e-commerce. Malaysia's bird's nest exports to China are estimated to be around RM2 billion. The two MOUs signed in this area are collaborations that are likely to strengthen compliance, acceptability and marketing of Malaysia bird's nest exports in China. These initiatives are important in light of China's ban on Malaysian bird's nest exports from July 2011 to December 2013. The other two

[12] Both Bandar Malaysia and EDRA are linked to the politically controversial government investment vehicle 1MDB. Chinese investments in Bandar Malaysia and EDRA have enabled 1MDB to reduce its debt.

trade-related MOUs are also aimed at enhancing access to China's market, but via e-commerce. The e-commerce MOU signed between MATRADE and Alibaba.com is an extension of their collaborations since 2014, and is aimed at enabling Malaysian SMEs to sell their products in China using Alibaba.com's B2B platform. The second e-commerce MOU is between Aladdin Group Sdn Bhd and Suzhou Lian Cheng Yihao Information Technology Co Ltd and involves the promotion of Malaysian halal products in China. Though these initiatives are not likely to impact Malaysia's trade deficit with China significantly, there are likely to be some gains given the size of the market in China. It also coincides with the desire of China's e-commerce giants such as Alibaba to increase their businesses with Southeast Asia.

CONCLUSION

The 14 MOUs and agreements signed by representatives from Malaysia and China in Beijing on 1 November 2016 does signify a deepening of economic relations between the two countries. This is not a recent trend, though the deals signify an acceleration of greater reliance on China for the implementation of new infrastructure projects in railways and ports. The Malaysian government is clearly optimistic that this will help accelerate the implementation of a number of its mega projects. However, there are risks, mainly associated with the uncertain prospects of some of the components of the mega projects.

Malaysia can potentially benefit from some of the new greenfield manufacturing investments from China and from greater access to China's market. The picture ahead is likely to be a mixed one – there will be some successes but also some setbacks. The latter could have serious consequences for the government's fiscal position in the future. For China, the recent developments represent an opportunity to deepen economic ties with Malaysia, which it sees as an attractive destination for its investments, a possible "hub" and a gateway of entry into Southeast Asian markets.

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Appendix: Other Major Investments and Projects in Malaysia Associated with Enterprises from China

Year	Main Investor	Investment/Project	Value (RM, bil)
2011	Zhuoda Real Estate Group	- Medini Iskandar	2.0
2012-2013	Country Garden Holdings	- Forest City Project costing RM175.8 billion (over 20 years) - Owns 60% equity in the developer Country Garden Pacific View Sdn Bhd	105.5
2013	Hao Yuan Investment Pte Ltd. (Singapore-based)	- Danga Bay - Mixed development - Joint venture: Hao Yuan (60%), Iskandar Waterfront Holdings (40%)	8
2013	Guangxi Beibu Gulf International Port Group Co Ltd	- Kuantan Expansion Port Project - Owns 40% equity in Kuantan Port Consortium Sdn Bhd	5
2013	China South Locomotive and Rolling Stock Corporation Ltd	- Railway manufacturing and maintenance centre in Batu Gajah, Perak - Supplier of light rail vehicles for Ampang Line Extension Project - Completed July 2015	0.4
2013	Comtec Solar Systems Group Limited	- Manufacturing plant for production of mono crystalline solar ingots and wafer - Samajaya Free Industrial Zone, Sarawak	1.2
2013	Guangzhou R&F Properties	- R&F Princess Cove Project, Johor	4.5 (land)
2014	Shandong Daiyin Textile and Garment Group.	- Textile plant in Sedenak Industrial Park, Kulaijaya, Johor	0.64
2014	Guangxi Beibu Gulf Iron & Steel Investment Co Ltd	- Integrated steel mill in Malaysia-China Kuantan Industrial Park (MCKIP)	3.5
2015	JinkoSolar Holding Co., Ltd.	- Photovoltaic (PV) Cell & Module Manufacturing Facility in Batu Kawan, Penang	0.4
2015	Agile Property Holdings Ltd	- Agile Mont Kiara Project (completion in 2019) - Owns 70% equity in RM1.4 billion project	1.4
2015	Greenland Group	Greenland Tebrau and Greenland Danga Bay, Iskandar Malaysia	4.39
2015	China General Nuclear Power Corporation	Edra Global Energy Berhad (Seller: 1MDB)	9.83
2015	China Railway Engineering Corporation	60% equity in Bandar Malaysia land bank (Seller: 1MDB)	2.97
2016	China Railway Port and Channel Engineering Group Co Ltd. & T.A.G Marine Sdn Bhd	Kuala Linggi International Port (KLIP)	12.5

Source: Author's compilation based on media reports.

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