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The Significance of China-Malaysia Industrial Parks

By Khor Yu Leng

EXECUTIVE SUMMARY

- China and Malaysia have jointly established the Malaysia-China Kuantan Industrial Park (MCKIP) and Qinzhou Industrial Park (QIP) to further boost bilateral trade and investment.
- Investment promoters see Malaysia as a country for China to reach markets within country-of-origin rules; and the state of Pahang where the MCKIP is planned will likely be selected as the gateway for bringing investment and jobs into the Malaysia Eastern Corridor, which covers an economically lagging area on the peninsula.
- Sources indicate that the industrial park projects are linked to two significant land deals. The first may relate to the QIP land swap arrangement for land in the Binhai township. The second, at the MCKIP, is said to include the conversion of some state-controlled land for the use of the industrial park.
- Country data indicates a large imbalance in FDI flows with the broad conclusion that Malaysia OFDI flows to China exceeds the reverse by a factor of five to eight times or even more. However these statistics may still misrepresent the picture since many Malaysian tycoons use Hong Kong as a base for their investments into China.
- To begin to correct this imbalance, Malaysia will quickly need to draw in China OFDI equivalent at least to what it has received in recent years from Germany. Such a rapid transformation in Malaysia-China investment outcomes is unlikely without more significant investment drivers in place.
- The relatively small size of the MCKIP (just over a tenth of the size of its twin project in Qinzhou) is suggestive of a continued imbalance in Malaysia-China foreign investments.

INTRODUCTION

China and Malaysia have established two joint industrial parks to further boost bilateral trade and investment. These are government-to-government promoted initiatives, and notably the third such bilateral effort by China after the Suzhou and Tianjin projects with Singapore. The Malaysia-China Kuantan Industrial Park (MCKIP), to be built on 1,500 acres, is located in the less developed Malaysia Eastern Corridor. Announced on 5 February 2013 at a ground-breaking ceremony attended by Jia Qinglin, chairman of China's top advisory body, and Malaysian Prime Minister Najib Razak, this industrial park is the twin project of the 13,600-acre Qinzhou Industrial Park (QIP) being built in Guangxi Province, also a less developed region of China. Investors taking up industrial land in Qinzhou are expected to be offered attractive land prices, tax incentives, and financial support. Similarly, Kuantan is also expected to offer investment incentives such as 5+5+5-year pioneer tax-free status, and generous capital allowances.

MCKIP is estimated to cost USD 806 million to develop. It hopes to secure total investments of USD 24 billion by 2020. Its key business areas include oil, electrical products and electronics, and car component manufacturing. While QIP has not reported its cost or its gross development value since its masterplan has yet to be finalized, a start-up area of 1,945 acres within QIP is estimated to cost USD 838 million. Slated to have a population of 470,000, QIP was launched on 1 April 2012 but a feasibility and investment agreement is still pending as of March 2013.

Malaysia hopes that MCKIP will help draw in Chinese outward foreign direct investment (OFDI) of USD 10 billion over the next five years. This would push China from its current lagging spot to a top ranked investor in Malaysia, and match its role as Malaysia's top trading partner.

But can the project really help boost and rebalance the overwhelming flow of Malaysia direct investments to China which dwarfs what China has invested in Malaysia? The data is partial and patchy, but several sources support a conservative estimate that Malaysia outward foreign direct investment (OFDI) to China is at least five times as big as China OFDI to Malaysia. As a point of reference, Chinese official data report its cumulative OFDI in Malaysia at USD 700 million in 2010.

In providing a preliminary answer to the above question, this paper examines the rationale for the bilateral projects and, in particular, analyses the site selection, economics, Malaysian electoral politics and geopolitical issues that have bearing on the projects.

ATTRACTING CHINA OFDI

Malaysia's investment promoters see it as a third country for China to reach markets within country-of-origin rules. Their continued focus on attracting China OFDI seems to be paying off now, with 2011 and 2012 as banner years. Earlier, Deputy International Trade and Industry Minister Datuk Mukhriz Mahathir said that Malaysia would seek increased FDI as "China is on the lookout for a third country like Malaysia to re-export its products to markets where it has exceeded the quota." He further adds that "Via an investment in Malaysia, Chinese manufacturers can effectively value-add their productions, and also meet the 40% content requirement put forward by the country to obtain the Certificate of Origin before they can start exporting under the label of Malaysia."

China's push factors include its go-global policy which has existed since 1999. However, the cheap credit post-Global Financial Crisis, especially to its state-owned enterprises (SOEs) may be a better indicator for the current expansion of China OFDI. China OFDI typically seeks to acquire raw materials, markets and technology. China has also in recent years faced a rising cost trend and significant hidden costs relating to intellectual property losses. This has led to key multi-nationals opting for capital-intensive plant expansion in less developed regions in other parts of the world. Malaysia's pull factors include market size (its immediate market may be limited but via free trade agreements or FTAs it is widened, though with constraints from country-of-origin rules), natural resources (some Chinese projects seem to target mineral deposits available in Malaysia), a high degree of openness with more investment incentives, cheap subsidized gas for industry, and good infrastructure. Malaysia also has some technological advantages in the steel and chemicals sectors that China investors will seek to acquire. On the negative side of the balance is Malaysia's need to enhance its human capital resources.

GEOPOLITICAL CONSIDERATIONS

Pahang will likely be selected as the Malaysia site, because PM Najib Razak hails from the state and 2013 is a big election year. Mr Najib was born in Kuala Lipis and is the MP of Pekan, both in Pahang. MCKIP is located north of Kuantan, Pahang's key city and port, on the East Coast. The project would bring investment and jobs to an economically lagging area of Peninsula Malaysia.

But why build a new industrial park when Malaysia already has good infrastructure with existing industrial park facilities that have yet to be fully utilized? For one thing, MCKIP is located within the Malaysian Eastern Corridor, which is a less developed area that is being promoted for investments. There, investors are offered extra pioneer tax-free status.

PM Najib announced the MCKIP project just before the Chinese Lunar New Year celebrations in 2013. He has said that MCKIP will draw in China OFDI of USD 10 billion over the next five years. About USD 3.4 billion of commitments have been reported—for a steel plant, aluminium processing, and a palm oil refinery plus for the expansion of Kuantan port.

The location of the MCKIP site close to the controversial Lynas rare earth processing facility is also noteworthy. Lynas has attracted a great deal of grassroots local (mostly ethnic Chinese) opposition in Malaysia, and has witnessed the launch of a green political movement against the project, for fear of serious environmental pollution. Chinese investors are seemingly unworried about the proximity to Lynas, however. Presumably, the show of confidence of the Chinese investors may be meant to signal to Malaysia's ethnic Chinese population that they should also have few worries about the maligned Lynas project.

Political analysts also observe that Najib's father, former PM Tun Abdul Razak Hussein chose a similar timing in 1974 to make a historic trip to Beijing, making Malaysia the first country in the ASEAN region to establish diplomatic relations with China. Is the so-called "Najib factor" a key driver for improved economic ties with China? (It did after all generate a visit from a China politburo member to officiate at MKCIP). Meanwhile, as the nearby South China Sea disputes rage on, it does China no harm to cultivate better relations with Malaysia with the promise of FDI and joint control of a port.

But are the China-Malaysia industrial park projects merely driven by a combination of economics, Malaysian electoral considerations and geopolitics? Some sources point out that the industrial park projects are linked to two significant land deals. The first relates to the QIP land swap arrangement for land in the Binhai township. According to a SP Setia Berhad company announcement:

> (QIP) is a greenfield area, requiring hefty infrastructure outlays before developments can take place…(and) approvals to allow up to 30% of the commercial and residential land of the 'start-up district' to be swapped for land in Binhai New Town (BNT) based on equivalent value. BNT's land is readily developable, enabling the group to better manage cash outflows from 'start-up district' infrastructure cost to property sales billings from BNT, which is less taxing on its balance sheet.

The second land deal, at the MCKIP, is said to include the conversion of some state-controlled land for the use of the industrial park.

KEY PLAYERS & KUANTAN INVESTMENT PLANS

In order to consider the prospects for the rapid take-off of the industrial parks projects, a review of the background of the private sector sponsors of the projects is in order. Private sector backers of the industrial parks are heavyweight state-linked developers. No doubt, these projects are still in the design stage but they bear watching. It is also worth noting that while some investment plans have been announced for the industrial park in Malaysia, there has yet to be significant plans for QIP in China.

The China consortium consists of China Guangxi Beibu Gulf International Port Group (CGBGIP) and Qinzhou Jinqu Investment Company Ltd (QJIC), which are both state-owned enterprises from Guangxi Province. CGBGIP was established in Nanning in 2007, and is the primary owner of three ports in the Beibu Gulf: Fengchenggang, Beihai and Qinzhou ports. It also has businesses in logistics, international trade, real estate, energy and environmental technologies with total assets amounting to RMB 221.6 (USD 35.7) billion at the end of 2011. In 2012, it ranked 446th in the Chinese Enterprise Confederation list with an operating revenue of RMB 20.3 billion; and is ranked 133rd in the list of top 500 Chinese Enterprises of the Service Industry. Its subsidiary, the Guangxi Qinzhou Free Trade Port Area Development and Investment Co., Ltd was established in 2008 with a capital of RMB 2.8 (USD 0.5) billion designated to develop the Qinzhou free port area. The second investor is QJIC, a company established in 2012. Wholly-owned by the Qinzhou City Development and Investment Group Co Ltd, its registered capital is RMB 100 (USD 16) million. Its parent company, owned by the Qinzhou City Government, engages in the operation and management of state-owned construction assets.

In the Malaysia consortium, Pahang state is expected to be a minority player in the MCKIP project, with no participation in QIP. Of interest are the substantive Malaysia partners, SP Setia Berhad with Mr Beh Hang Kong and Rimbunan Hijau with Mr James Lau Sze Yuan. SP Setia was a fast-growing Malaysian private-sector property developer, and was reported as the largest public-listed developer when it was taken over by Permodalan Nasional Bhd, a key state-controlled fund, in late 2011. SP Setia's asset base was RM 9.4 (USD 3.1) billion with a share capital of RM 1.5 (USD 0.5) billion in 2012. Its founder, Liew Kee Sin remains with the property group and property sector sources reckon that he is doing "national service" by taking a lead role in the MCKIP project.

Beh is a key individual investor in MCKIP. In addition to his role in SP Setia, he is also Managing Director of VTI Vintage Bhd, a Malaysia public-listed roofing company. VTI Vintage's annual report offers an insight into his background:

> He started his career in 1980 as a part-timer for the China Press. In 1982, he was employed as a Regional Executive Secretary by the Malaysian Chinese Association. He left this position in 1985 to establish a company involved in the marketing of office equipment. He is also extensively involved in property development and investments in various industries. He also held the position of Municipal Councillor for the Majlis Perbandaran Shah Alam from 1986 until 1990.

Thus, Beh appears to have old links with Rimbunan Hijau via China Press, and he seems well-established in Malaysia's ruling coalition and its construction industry.

Rimbunan Hijau is a Sarawak-origin conglomerate with key businesses in timber, palm oil, media and finance. Tiong Hiew King of Sibu, Sarawak is the founder and James Lau is his son-in-law. The group has the controlling interest in as many as six publicly listed companies in Malaysia and Hong Kong: Jaya Tiasa (timber, palm oil), Subur Tiasa (timber), Rimbunan Sawit (palm oil), Media Chinese International Limited (media, Malaysia and HK) and EON Capital (finance). In Sarawak, it is the biggest timber player with over 1 million ha of timber concessions and 555,000 ha of reforestation licenses. It also has 130,000 ha of oil palm land bank. It also has international subsidiaries (e.g. Rimbunan Hijau [PNG] Group, Mafrica Corporation Sdn Bhd), and large concessions in Papua New Guinea, Africa (Gabon, Equatorial Guinea) and Russia among others. Local brokers reckon Rimbunan Hijau's participation is merely as an investor, leaving SP Setia and Beh to take charge.

CBGCIP has also bought a 40% stake in the Kuantan Port Consortium Bhd (a subsidiary of IJM, a public-listed construction group) which is in charge of the development and expansion of the Kuantan port in Pahang, for RM 310 (USD 100) million. It plans to invest, together with IJM, a further RM 3 (USD 0.97) billion in the port. The company says it will also invest some RM 5 (USD 1.6) billion in the development of an integrated steel plant, an aluminium processing plant and a palm oil refinery (in which Rimbunan Hijau is also involved) in MCKIP.

THE ECONOMIC IMBALANCE

The trade relationship between China and Malaysia is overwhelmingly (44%) about electronics and electrical products. Malaysia-China trade was worth RM 180 (USD 58) billion in 2012. Malaysia's key imports from China are electronic integrated circuits and micro-assemblies, automatic data processing machines, ICT equipment, office equipment, printed circuits, electrical transformers, transport equipment. Malaysia's

key exports to China are electronic integrated circuits and micro-assemblies, palm oil & derivatives, automatic data processing machines, rubber, oil & gas, processed edible oils, semiconductors. China has been Malaysia's number one ranked trading partner since 2009. Its share of Malaysia trade rose from 9.5% in 2006 to 13.8% in 2012. Malaysia's top five trading partners account for about 50% of its total trade value.

The Statistical Bulletin of China's OFDI records USD 5.6 billion in cumulative flows into China from Malaysia versus USD 709 million moving from China to Malaysia up to 2010. Bank Negara's data offers a clearer basis for comparison (in line with international recommendations) compared to China's data which remains sketchy. Bank Negara's data measures the stock of Malaysia FDI in China at USD 1.9 billion versus USD 363 million received from China.

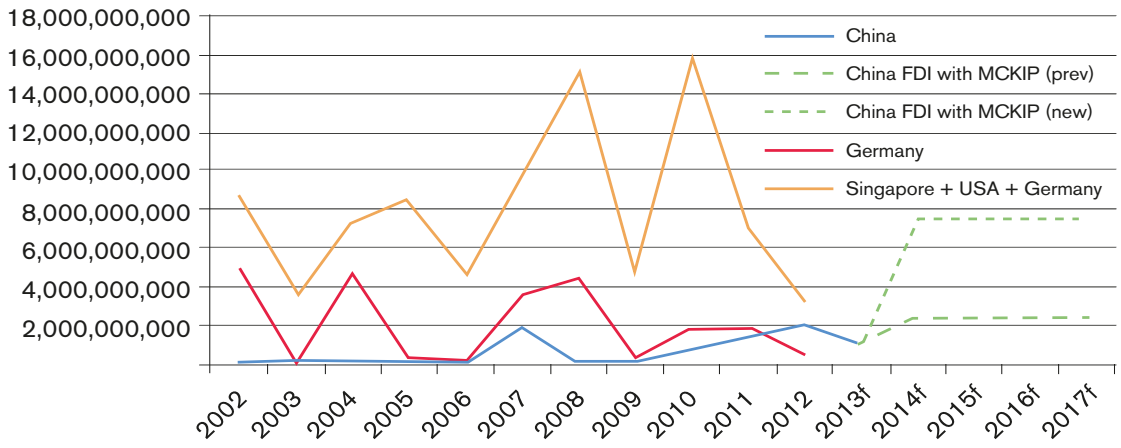
The data differ greatly but both show a large imbalance in FDI flows. The broad conclusion is that Malaysia OFDI flows to China exceeds the reverse by a factor of five to eight times, or even more. But these statistics may still misrepresent the picture as many Malaysian tycoons use Hong Kong as a base for their investments into China, notably Mr Robert Kuok. Thus, the USD 5.6 billion cumulative inflow of Malaysia-sourced investments recorded by the Chinese authorities and the imbalance indicated probably underestimate the situation.

A RAPID EXPANSION AND TRANSFORMATION IN CHINA OFDI?

Malaysia has big hopes for MCKIP to draw in RM 10 to 30 (USD 3.2-9.7) billion in the next five years. Such numbers, if achieved, point to a rapid and radical transformation of Malaysia-China investment outcomes.

To hit the expected China FDI target, Malaysia will quickly need to draw in China OFDI equivalent to what it has received in recent years from Germany (to achieve the low forecast) or a Singapore plus USA plus Germany combination (for the higher forecast). Figure 1 illustrates these forecasts. Such a rapid transformation in Malaysia-China investment outcomes may not be easy, without more significant investment drivers in place. Furthermore, MCKIP's relatively small size of 1,500 acres (just over a tenth of the size of its twin project in Qinzhou of nearly 13,600 acres) is suggestive of a continued imbalance in Malaysia-China foreign investments.

Figure 1: Malaysia Key FDI Sources and Forecasts: China FDI with MCKIP (RM, Ringgit Malaysia)



Source: Khor Yu Leng Data: MIDA FDI statistics received via personal communication, March 2013.

It is still early days yet where the China-Malaysia industrial parks projects are concerned, and the companies are just starting to take up position. Given that the QIP project has yet to announce its masterplan and a land swap with Binhai Township appears to be a key financing issue, it is possible that MCKIP will be the first to launch. The emergence of more promoters and the roll-out of more industrial projects can be expected to set the stage for its eventual take-off.

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