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Chinese Investment in Malaysia: Five Years into the BRI

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EXECUTIVE SUMMARY

- Since there is no mutually agreed definition for BRI projects, in Malaysia and in other participating host economies, this paper considers all Chinese investment to be within the BRI framework.
- Chinese foreign direct investment (FDI) in Malaysia increased after 2014 and is spread over diverse sectors.
- In manufacturing, China uses Malaysia as an export platform to other countries, with mimetic entry that is aided by fiscal and non-fiscal incentives offered by Malaysia.
- Chinese investment projects also include high risk mega projects that are financed by loans guaranteed by the Malaysian government and managed by special purpose vehicles.
- There are no data with which to calculate and verify if the total loan amount will come to exceed inflows of Chinese FDI at some point in the future.
- Malaysian concerns include the increasing presence of Chinese foreign workers and expatriates in the country, the crowding out of local SMEs, and the relatively high economic risks of mega projects.
- For mega projects that are funded by public money, improved transparency in financial details should help ease public misgivings about them.

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INTRODUCTION

China's launch of the "One Belt, One Road" (OBOR) vision in 2013, subsequently rebranded as the "Belt and Road Initiative" (BRI), has dominated the global investment landscape by its sheer size, scale and scope. It's five key goals, namely policy coordination, facilities connectivity, unimpeded trade, financial integration, and people-to-people connectivity practically cover all sectors. The total amount of BRI funding in terms of outstanding loans or equity investment as at the end of 2016 is estimated at USD292 billion.¹ The number of countries engaged in the BRI are divided into what China calls "one axis and two wings": 15 countries neighbouring China are in the axis while 24 countries in Europe, Africa and a few countries in Asia constitute the east wing, and seven countries in Latin America and the South Pacific make up the west wing.² Malaysia is strategically located within the axis and has tapped on the BRI to increase inflows of FDI into the country.

Despite Malaysia's overall welcoming stance towards FDI, there is considerable domestic dissent towards the increasing presence of Chinese investment in the country.

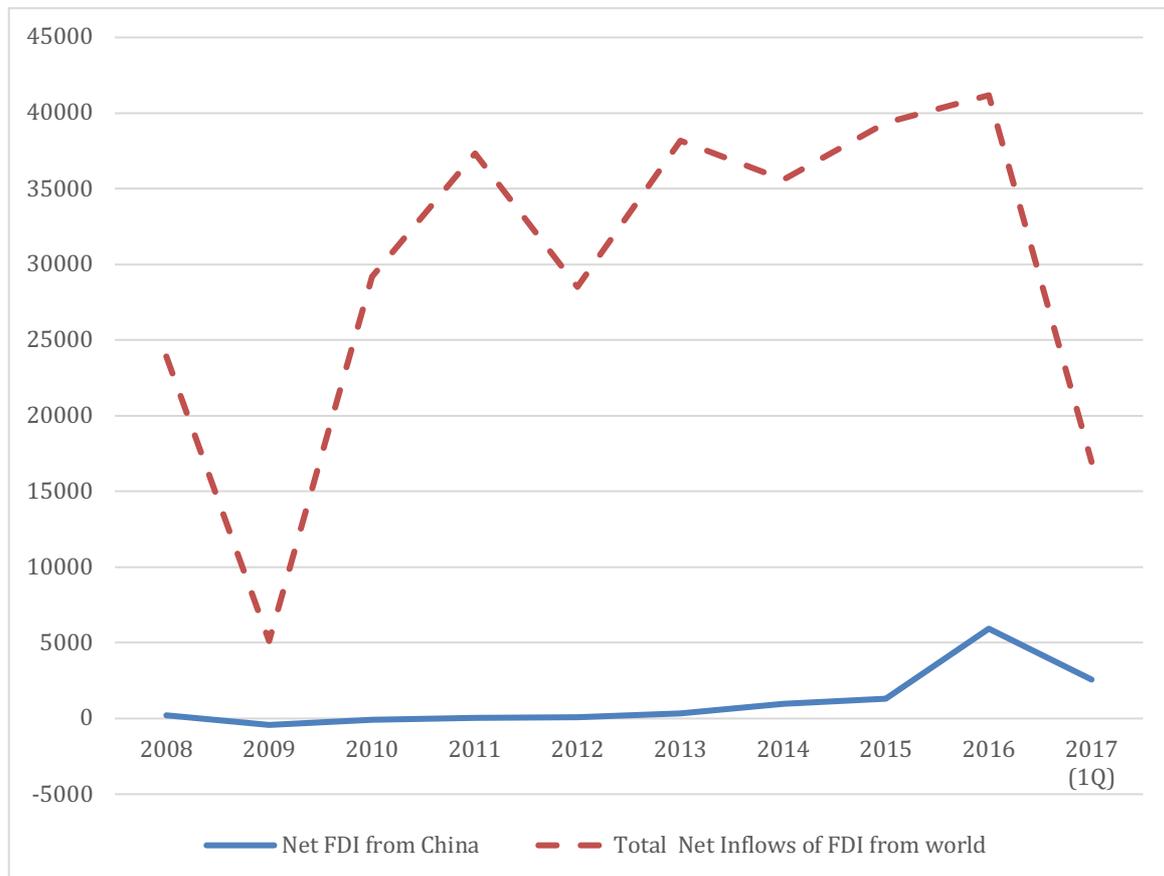
The purpose of this article is to clarify the nature of Chinese investment in Malaysia and the main areas of concern, despite their potential economic contributions.³

CHINESE INVESTMENT IN MALAYSIA

Up to 2012,⁴ Malaysia was a relatively small recipient of Chinese investment while Singapore has been the largest recipient of Chinese investment in Southeast Asia, followed by Indonesia, Thailand and Vietnam among the ASEAN-6. Therefore, although China's outward bound investment started to escalate after the implementation of its "go global" strategy, and accession to the World Trade Organization (WTO) in late 2001, it was the announcement of the Belt and Road Initiative (BRI) in 2013 and subsequent sale of the power assets under Edra Global Energy Bhd. to China General Nuclear Power Corporation (CGN), as reported in 2015,⁵ that drew the public's attention to Chinese investment in Malaysia.

Figure 1 shows an increase in net inflows of FDI from China from 2014 onwards. In 2008, net FDI from China constituted 0.8% of total net inflows of FDI into Malaysia, with the share increasing sharply to 14.4% in 2016.

Figure 1: Net Foreign Direct Investment (FDI) from China and Total Net FDI from world, 2008-2017 (1Q), (RM million)



Notes: Net = Credit minus Debit. Credit refers to inflow of funds or amounts received by direct investment enterprise in Malaysia from foreign direct investor and affiliate in the form of equity capital, reinvested earnings, loan transactions, trade credits as well as other capital receipts. Debit refers to outflow of funds or amounts paid to foreign direct investor and affiliate from direct investment enterprise in Malaysia due to liquidation of investment, loan transactions, trade credits and other capital payments (BNM).

Source: Bank Negara Malaysia and Department of Statistics

Though small, there was Chinese investment in Malaysia prior to the announcement of the BRI (Table 1).⁶ This included notably Huawei and ZTE’s entry into Malaysia’s telecommunications sector in 2001 and 2004 respectively⁷ and automobile producer Chery’s investment in 2008 before 2010.⁸ For the period between 2010 to 2012, Table 1 shows that metals, real estate and transport were the main recipients.

Table 1. Sectoral Distribution of Chinese Investment in Malaysia, 2005-2017 (USD million)

	Agri- culture	Energy	Finance	Metals	Textiles	Real Estate	Technology	Transport	Grand Total
2010				350					350
2011				1040		790			1830
2012						330		130	460
2013		380		650		1960		610	3600
2014					200	380			580
2015		6060				660	370	280	7370
2016		240		140		210		1970	2560
2017	280		120			280		110	790

Notes: The table above only records transactions that are over US\$100 million. The data in this Table is by no means comprehensive and is at best indicative.

Source: American Enterprise Institute

What is frequently attributed to be BRI projects are the 14 Memorandum-of-Understanding (MOUs) between business to business that were signed during Prime Minister Datuk Seri Najib Razak's official visit to Beijing in November 2016.⁹ These cover a broad range of sectors from railways, ports, real estate, steel manufacturing, finance, solar cells manufacturing, bird's nest, e-commerce, pharmaceutical, and information technology.¹⁰ It is unclear at this point whether all the 14 MOU projects will be implemented.

There is also as yet no mutually agreed list of BRI projects between Malaysia and China.¹¹ This is not peculiar to Malaysia since there is no agreed-upon definition for what qualifies as a BRI project in all participating host economies with China.¹² And although the BRI was officially launched in November 2013, projects started years earlier are often counted as BRI projects. For this reason, this paper considers it most reasonable to include all forms of investments from China as BRI investments.

Table 1 shows that besides transport, real estate is a big recipient, with the partnership between Country Gardens and supposedly the Johor state government¹³ to develop Forest City as announced in 2013, being the largest thus far. Other non-manufacturing recipients include agriculture, finance, and technology, indicating a diverse range of investments.

Manufacturing investment

Approved investment in the manufacturing sector in Malaysia expanded progressively from a mere RM0.6 billion in 2010 to a peak of RM4.8 billion in 2016, when China became the largest investor in this sector for the first time.¹⁴ This constituted 17.4 per cent of total approved foreign-owned manufacturing, or 33 projects in total. Cumulative approved investment from 2010 to 2016 amounted to RM18.2 billion, focussing primarily on basic metal, electric and electrical, and non-metallic mineral products. In the same period, 197

(out of 282 approved) China-related manufacturing projects worth RM14.0 billion have been implemented, generating employment for 30,341 people.¹⁵

The relatively low level of approved manufacturing investment prior to 2012 reflected Malaysia's general decline in attractiveness as a host economy for manufacturing investment, especially in labour-intensive manufacturing. The Malaysian domestic market is relatively small so that accessing it alone for foreign companies has been less attractive compared to accessing larger countries in Southeast Asia. China's entry into manufacturing is primarily motivated by the wish to access the domestic and other markets via Malaysia's regional trade agreements, thus using Malaysia as a springboard to enter the ASEAN market. Likewise, investments in the solar sector was made for the purpose of exporting to the US, to circumvent US anti-dumping duties on imports of solar panels from China at that time. Similarly, textile investment was made in light of the Trans-Pacific Partnership agreement that was being negotiated at that time. Steel manufacturing at the Kuantan Industrial Park is operating under export conditions as only certain types of steel not produced in Malaysia are allowed to be sold in the domestic market. Geely's investment in Proton is to supply the beleaguered car manufacturer with new technology such as an engine that meets the Euro 6 emission standard, hybrid engines and pure electric engines, which will then enable Proton to access other markets across ASEAN.¹⁶

The rise in manufacturing investment also shows the bandwagoning effect¹⁷ of other Chinese investments in the country, especially in infrastructure such as ports and railways, as these investments ease the entry and exit of Chinese inputs and outputs produced in the country to other parts of Malaysia and the rest of ASEAN. The expansion of the Kuantan port, including its approval to operate as a Free Zone port¹⁸ and the development of an industrial park next to the port are important steps in this direction as the port is strategically located at the quickest and most direct route between Malaysia and ports in China's eastern region. Another important component in this equation is the East Coast Rail Link (ECRL) that will enable goods to move from Kuantan Port to Port Klang, saving about one and half day sailing time, provided the rail link is extended from Gombak to Port Klang.¹⁹ Fiscal and non-fiscal incentives in the form of land provide additional inducements for Chinese investment in these dedicated zones.

Non-FDI projects: Loans and Technology Partnerships

Government to government projects are or will be primarily funded through loans that are transacted through non-affiliated companies, with China providing the technology needed.²⁰ The data on these transactions are not captured by traditional FDI data since they do not comply with the standard definition of FDI. Instead, these transactions are registered as "Other investments" in Malaysia's Balance of Payments data, which is also unpublished by country, unlike FDI data.²¹ The ECRL project is an example, whereby the projected cost of the project at RM55 billion will be funded by a soft loan from Exim Bank of China (85 per cent of project cost) at 3.25 per cent interest. The balance of 15 per cent will be funded through sukuk (i.e., Islamic bonds).²² A special purpose vehicle (Malaysia Rail Link Sdn. Bhd.) has been founded to manage the project. Similarly, the Trans Sabah Gas Pipeline (TSGP) will be funded by a soft loan of RM4.53 billion from the Exim Bank of China and

guaranteed by the Malaysian government. A special purpose vehicle, Suria Strategic Energy Resources Sdn. Bhd. (SSER), wholly owned by Malaysia's Ministry of Finance, has been established to manage the project, while the China Petroleum Pipeline Bureau (CPP) is the project's engineering, procurement, construction and commissioning (EPCC) contractor.²³ FDI data therefore understate the extent of Chinese investment in Malaysia. The total amount of loans undertaken for financing these types of projects is unknown, but a good indicator is that a simply calculated average of the loan amount of the ECRL project alone over the projected duration of eight years made up as much as 16.6% of net FDI flows to Malaysia in 2016. It is unclear whether the annual loan amount of all the loan-financed projects will exceed the net inflows of Chinese FDI into Malaysia at some point in the future.

In the case of the Digital Free Trade Zone (DFTZ) launched in November 2017, the first phase of its development is funded by POS Malaysia,²⁴ with Alibaba providing the technology and platform to facilitate cross border trading and e-commerce adoption by local small and medium enterprises (SMEs). Alibaba is supposed to contribute towards greenfield investment in the second phase through a partnership between Malaysia Airports and Alibaba's logistics arm, Cainiao Smart Logistics Network, although the amount and terms were not yet disclosed, at the time of writing this article.²⁵

OPPORTUNITIES AND CHALLENGES

Traditionally, FDI brings in capital and creates employment as well as technology transfer opportunities. Chinese investment in Malaysian manufacturing has the same potential as other FDI to contribute towards economic growth through employment and technology transfer. The extent of technology transferred depends on a complex mix of absorptive capacities of local firms and workers, global and regional strategies of the multinationals involved as well as host country policies. The literature shows cases where localization has taken place as well as cases where it has not in the older Chinese investments in Malaysian manufacturing.²⁶

It is the investment in large-scale non-manufacturing activities that generates the greatest domestic concerns in Malaysia.²⁷ These concerns include an increasing presence of Chinese foreign workers and expatriates in the country, the crowding out of local SMEs and the relatively high economic risks of mega projects that are funded by loans guaranteed by the government rather than through direct investments. Unpublished data from the immigration authorities indicate that Chinese foreign workers are largest in construction and services and relatively small in manufacturing and agriculture. The data also show an increasing trend over the years, although Chinese workers do not as yet constitute the largest group of foreign workers and expats in the country. SMEs' fears come from the tendency for China to control the whole supply chain in their outbound investments and pricing out local SMEs in the process.²⁸ The fears of large accumulated debts from high risk projects at a time of increasing domestic fiscal constraints are ignited in part by the example posed by Sri Lanka,

where in 2017, the commercial activities of Hambantota port was handed over to China Merchants Port Holdings on a 99-year lease in exchange for US\$1.1 billion in debt relief.²⁹

CONCLUSION

Chinese investment in Malaysia is spread across many sectors, including manufacturing. This is not surprising given the general heterogeneity in Chinese investments abroad.³⁰ Mimetic entry can be observed with an increase in manufacturing investment as Chinese firms follow the BRI vision of their leaders, especially in infrastructure development that eases the movement of Chinese inputs and outputs and in response to fiscal and non-fiscal incentives provided by the Malaysian government.

There is also a public debate as to whether Chinese investment is about loans or about FDI. Data show that both types of financing are involved, with China providing the technology in the projects financed by mega loans. It is unclear at this point whether the loan amount will become more or less than net inflows of FDI into the country at some point in time. The risk varies with the form of financing and the scale of project. Some projects are riskier due to the scale of investment, uncertainty over demand and pricing as well as the project's viability at the projected cost. Privately funded projects or where the Malaysian partner is a private company with the bottom-line dictating the viability of a project, indicate a higher probability of success. For mega projects that are funded by public money, improved transparency in the financial details of the project will ease public misgivings about these projects.

- ¹ See Financial Times, undated. “In Charts, China’s Belt and Road Initiative”. <https://www.ft.com/content/18db2e80-3571-11e7-bce4-9023f8c0fd2e> <Accessed 13 February 2018>.
- ² Deloitte, 2018. “Embracing the BRI ecosystem in 2018”. <https://www2.deloitte.com/insights/us/en/economy/asia-pacific/china-belt-and-road-initiative.html> <Accessed 13 February 2018>.
- ³ It should be noted that the focus in this paper is solely on the economic dimensions of Chinese investment in Malaysia.
- ⁴ See for example, the United States Government Accountability Office, 2015. “Trends in U.S. and Chinese Economic Engagement”, August. Also, Lim, G. 2015. “China’s investments in Malaysia: Choosing the “Right” partners”, *International Journal of China Studies*, 6(1): 1-30.
- ⁵ The Star online, 23 November 2015. “1MDB sells Edra power assets to China firm for nearly RM10b cash”. <https://www.thestar.com.my/business/business-news/2015/11/23/1mdb-sells-edra-power-assets-to-china-firm-for-nearly-rm10b-cash/> <Accessed 5 February 2018>.
- ⁶ Official data generally does not disclose the distribution by sectors. In response to the lack of data, the China Global Investment Tracker (CGIT) is published by the American Enterprise Institute (AEI) and the Heritage Foundation launched a data set covering China’s global investment and construction activity from 2005 onwards. It only records those transactions that are over US\$100 million, giving the year and mode of entry as well as the sectoral distribution. It should be noted that the data in this Table is by no means comprehensive and it is at best indicative.
- ⁷ Li, R. and Cheong, K.C. 2017. “Huawei and ZTE in Malaysia: The Localization of Chinese Transnational Enterprises”, *Journal of Contemporary Asia*, Vol. 47. No. 5: 752-773.
- ⁸ Zhang, M., Rasiah, R. and Lee, J.K. Y, 2017. “Navigating a Highly Protected Market: China’s Chery Automobile in Malaysia”, *Journal of Contemporary Asia*, Vol. 47. No. 5: 774-791.
- ⁹ The Star online, 1 November 2016. “M’sian, Chinese firms sign agreements worth RM144bil”, <https://www.thestar.com.my/business/business-news/2016/11/01/malaysian-and-chinese-firms-sign-14-agreements-worth-rm144bil/> <Accessed 5 February 2018>.
- ¹⁰ Ibid, page1-2.
- ¹¹ Based on interviews with Ministry of International Trade and Industry (MITI) Malaysia and discussions with researchers from Chinese Academy of Social Sciences (CASS) in 2017. MITI is working towards an agreed list with China, which it will then list on its web-site. But this has yet to materialize at the time of writing this paper.
- ¹² Hillman, J.E., 2018. “China’s Belt and Road Initiative: Five Years Later”, CSIS. <https://www.csis.org/analysis/chinas-belt-and-road-initiative-five-years-later-0> <Accessed 6 February 2018>.
- ¹³ See Williams, J.M.R. undated. “Evaluating Megaprojects: the case of Forest City in Johor, Malaysia”, on the ultimate investor in Forest City. <https://scienceimpact.mit.edu/sites/default/files/documents/Williams.pdf> <Accessed 5 February 2018>.
- ¹⁴ Unpublished MIDA data.
- ¹⁵ Lee, H. G., 2018. “China’s BRI in Malaysia: Can it be a win-win partnership”? Power-point presentation at *Belt and Road Business Forum and Symposium 2018*, at Universiti Tunku Abdul Rahman, Sungai Long., 6-7 January.
- ¹⁶ SunBiz, 3 October 2017. “Li’s appointment another step towards Proton’s recovery: Research house. The Sun, Tuesday, page 13.
- ¹⁷ Based on discussions with CASS research fellows, 16 October 2017 at ISIS Malaysia. Provincial governments and private sector tend to mimic entry into overseas markets of the Central government agencies, especially for BRI initiatives. The literature also shows mimetic entry of Chinese investors to be important. See De Beule, F., Somers, D. and Zhang, H. 2017. “Who Follows Whom? A

Location Study of Chinese Private and State-Owned Companies in the European Union”, *Management International Review*, Published online 03 November 2017.

¹⁸ As announced on the website of Kuantan port, it has received approval to operate as a Free Zone port in June 2016. http://www.kuantanport.com.my/en_GB/port-info/free-zone/ <Accessed 5 February 2018>.

¹⁹ Tay, C. 2017. “Kuantan Port: ECRL’s Phase 2 crucial for direct transfer of cargo to Port Klang. *The Edge Malaysia*, September 4.

²⁰ Interview with the Ministry of Finance in 2017.

²¹ Based on discussions with a Central Bank officer on the compilation of Balance of Payments data in Malaysia.

²² Kana, G. and Kaur, G. 12 August 2017. “The real economics of ECRL”, *Starbizweek*, Saturday, 12 August, pages 14-15.

²³ As reported in *The Edge*, 8 November 2017. <http://www.theedgemarkets.com/article/rm45b-trans-sabah-gas-pipeline-be-funded-loan-china-guaranteed-malaysia> <Accessed 5 February 2018>.

²⁴ POS Malaysia is reportedly investing US\$14 million (or estimated RM60 million) to upgrade and renovate the KLIA Air Cargo Terminal 1 facility to serve Lazada and other eCommerce players in the DFTZ. See <https://www.digitalnewsasia.com/digital-economy/high-hopes-dftz-boost-malaysia%E2%80%99s-cross-border-trade> <Accessed 6 February 2018>.

²⁵ *Ibid*, page 1.

²⁶ See *Op cit.*, Li and Cheong, pages 759 and 765; and Zhang et al., pages 784-786.

²⁷ It should be noted that China has its own concerns over the viability of some of its outbound investments and it is increasingly moving towards tighter control over these investments as they have the potential to undermine stability in its capital account.

²⁸ Teoh, S. and Leong, T. 2017. “Chinese deals in Malaysia under scrutiny”. *The Straits Times*, 7 May. <http://www.straitstimes.com/asia/se-asia/chinese-deals-in-malaysia-under-scrutiny> <Accessed 6 February 2018>.

²⁹ See <https://www.reuters.com/article/sri-lanka-china-ports/sri-lanka-hands-port-formally-to-chinese-firm-receives-292-mln-idUSL3N1O908U> <Accessed 6 February 2018>.

³⁰ Kaplinsky, R. 2012. “No simple pattern to Chinese foreign investment”. *East Asia Forum*, 4 (2): 24-26.

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