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In Pursuit of Connectivity: China Invests in Southeast Asian Infrastructure

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EXECUTIVE SUMMARY

- In the 1980s, China began to benefit from foreign funding and companies sharing their expertise and knowledge in building energy and transportation infrastructure in China. Today, China offers to share its successful development experience with other countries through the Belt and Road Initiative.
- Rather than view the initiative as primarily extending China's strategic and political influence, it is important to assess each project on its economic merits, including how these infrastructure networks can serve as a catalyst to promote industrialization and urbanization in the host country.
- The Hambantota port in Sri Lanka is often portrayed as a classic example of China's debt trap. Yet, the Chinese company involved could have easily terminated its involvement and walked away. Instead, it remained committed to developing not only the port but related projects such as industrial zones and logistical networks.
- The host country has to share responsibility together with China in the design and implementation of any Belt and Road project. They should insist on principles and processes such as disciplined project financial governance, local labour usage and skills diffusion.

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INTRODUCTION

Five years into China's invitation for Southeast Asian economies to work in synchrony toward an envisioned 'maritime silk road', skepticism in the region risks being proven correct. Signature projects such as railways in Indonesia and Thailand are facing either chronic delays in construction, or protracted renegotiation. Port projects in Malaysia and Cambodia face questioning about geostrategic goals and economic viability upon eventual completion. China-loaned railway and oil/gas pipeline projects in Malaysia, also constructed by Chinese companies, made headlines in Malaysia's election debates and were suspended when the new government assumed office. Negativity, at least in the mass media and policy discussion circles across the region, is a key feature of the state of progress and even future prospects of connectivity projects by China.

In a material sense, Chinese investment in maritime ports, airports, railroads and highways, all designed to enhance flows of trade in goods and tourism within the region and beyond, is needed in the region. As a matter of fact, with regard to many of the construction projects under the media limelight, the Chinese involvement helped to fill a development void that has existed for decades, if not longer. For these projects to become successful, beginning with a controversy-free construction phase, the continuing international questioning about ulterior motives behind China's efforts does not augur well for either China or recipient societies that welcomed Chinese investment in the first place. The more productive orientation is to critically examine the issues at hand and find ways to improve the level of collaboration toward enhanced connectivity.

CHINA DOES UNTO OTHERS AS IT LEARNED HOW

When it comes to Chinese economic engagement in Southeast Asia, perhaps by far the most well-known case that lends credit to questioning ulterior motives is China's offer to provide both the loan for and the construction of a hydrological dam in northern Myanmar. Suspension of the Myitsone Dam – after two years of construction -- was hailed by anti-dam activists as an exemplary case of success in a worldwide anti-dam movement.¹ Some analyses take the case to a higher level and question the Chinese development model.² To an extent, in many international contexts, the mentioning of Myitsone Dam is synonymous to warning against preordained failure.

The fate of the dam is beyond the scope of this discussion. But, it may be useful for observers of the economic dynamics between a Southeast Asian country and China to take note of China's own experience in tapping foreign assistance to develop its own infrastructure projects.

In 1982, China decided to make use of a World Bank loan to construct the Lubuge hydropower station.³ This was a project – a rock-fill embankment dam on a river in a mountainous area full of karstic rock formations – which China's own scientists, engineers and companies had tried but failed to accomplish for three decades prior. One dimension of the constraint was that the site sits on the borders of Guizhou and Yunnan provinces in Southwest China, geographically

too distant to attract investment without intervention by the central government. As described in World Bank archive documents, Lubuge was the first project where China's hydropower companies functioned as subcontractors to a consortium of foreign companies whose governments had contributed to the underwriting of the loan.⁴ The project was successfully completed and the rest is history.

For China, the policy significance of Lubuge has gone way beyond managing the very project itself. Even before its formal completion, the State Council (cabinet) decided to promote the project's financial and operational modalities across all applicable industries in the country. The hydroelectric industry in particular took Lubuge as a starting point for reforming itself.⁵ For China's hydropower industry, experience from working with international actors in China played a large role in the designing of operations and expectations of treatment abroad.⁶

Indeed, China's own experiences, project by project, in relating to international financial institutions like the World Bank and investors from the private sector very much like those in other societies, accumulated to form an understanding about norms for conducting foreign investment, even as China became the party doing the lending. In Chinese reckoning, projects like Lubuge, precisely due to its geographical isolation, deserve a chance to see the light of the day, as electric power is indeed essential for economic growth and family and individual comfort.

However, such sentiments can turn out to be too naïve since each society operates on its own value systems, among many other factors. Still, knowledge about such developments within China should help encourage the questioning of speculation about wilful disregard of socio-political conditions abroad and/or even the longing for geostrategic domination. Accepting the existence of good faith is one useful step along the path towards amicable interactions.

“LOOK SOUTHEAST” IN RECENT CHINESE HISTORY

A standard refrain in the assessment of China's handing of its ties with Southeast Asia is that China seeks to dominate (individual states) and divide (ASEAN). In addition to the usual list of long standing issues particularly sensitive to the region such as the South China Sea, there exists a constant debate about having to side with either Washington or Beijing when it comes to preference for regional order.

But it is overly simplistic to view Southeast Asia as little more than an object for geostrategic competition between Beijing on one side, and Washington and its allies in Asia and beyond on the other. Indeed, during the early decades of the Cold War, that binary mode of analysis helped to justify military conflicts in Vietnam, Laos and Cambodia, leading to the loss of millions of lives. Avoidance of military conflict is indeed a valuable lesson to learn from history.

Post-WWII Southeast Asia, with its rapid economic development out of the ravages of war, functioned as a source of inspiration for China when the latter emerged out of the self-imposed destruction of the Cultural Revolution. The potential for trade, both as final destination and

conduit to markets around the world, and investment opportunities in Southeast Asian markets was a practical motivation for China to select its four coastal cities as ‘special economic zones’ in late 1979. China cultivated ethnic Chinese businesses throughout Southeast Asia to develop their ancestral hometowns. Along with such human ties came the transfer of practical know-how in attracting foreign direct investment. In the early 1980s, then-deputy prime minister of Singapore, Dr Goh Keng Swee, was among the few eminent regional leaders invited to serve as economic advisors to China’s State Council. The value of Southeast Asia as a source of human and social capital to China can also be seen in China’s selection of Singapore, Malaysia and Thailand to be the first batch of approved tourism destinations in 1990.

In the realm of political diplomacy, it was not until July 1991 that China managed to be inducted into the group diplomacy exercise of ASEAN. China’s foreign minister Qian Qichen attended the annual meeting of his ASEAN peers as a guest of the Malaysian government. Five years later, ASEAN accorded China full dialogue partner status. Over the years, ASEAN selected nine countries and the European Union as its dialogue partners, in addition to playing host to a number of multilateral forums on security and development. In other words, in the actual world of diplomatic practice, ASEAN is not as small and feeble as is often made out to be. ASEAN has followed equidistance with each of the major powers.

A short conclusion to draw is that since China and many Southeast Asian governments and certainly ASEAN as a collective entity, have a fairly short history of formalized governmental level interactions with each other, it is natural that each side continues to grope for symmetrical means of relating to each other. As neighbours that cannot move away from one other, in the end, commitment to building on resilience from the recent past has to prevail.⁷

TOWARDS IMPROVED CONNECTIVITY

At this juncture, it is useful to discuss the notion of connectivity. In documents produced by Chinese government agencies, connectivity is specified as proposals for concrete economic cooperation projects. It has become standard for references to five layers of connectivity: policy, infrastructure, trade, finance, and people-to-people relationships.⁸ As a matter of fact, similar listings can be found in documents for promoting regional integration, in ASEAN and many other parts of the world.

Standard questioning on the part of some Southeast Asian and other international observers arises over what kind of authority China has to one-sidedly initiate a programme of connectivity that can turn out to be forbearing in implementation. At issue, against the background of asymmetry in diplomacy, is Southeast Asian imageries of a distant past known as a tributary order centred around ancient Chinese dynasties. The extended question has to do with the ultimate goal of China: is the end objective a restoration of that dynasty-era past?

These and more lines of questioning each has its own set of justifications. My contention is that laws of economic geography should be given considerable and perhaps even more weight than concerns about motives as summarized in theories of geo-economics and geopolitics. It is

the laws of economic geography that should inform and guide the search for specific ideas and practices of connectivity. This is also a fitting approach to discuss ASEAN-China connectivity as well. All ASEAN member states, with the exception of Laos (with only land neighbours), is endowed with its own access to the ocean, which in turn offers the most convenient and cost-effective means for conducting international commerce with all economies around the world. In other words, for each Southeast Asian economy, connectivity with China is far from being the totality of its endeavours. Furthermore, connectivity with China, as with any other entity in the world, is a two-way process full of trials and errors. The match of necessities is what underpins chances of success for any initiative, from whomever it comes.

A key component of connectivity between China and Southeast Asia is and has to be increased Southeast Asian presence in China's domestic markets. Projects like the annual China Import Expo, organized by the government and to be inaugurated in Shanghai in November 2018, add to similar venues that promote sales of foreign-made products directly to Chinese consumers.⁹ An interesting development to take note of is that inbound investment is a component in official Chinese statistics on its 'Belt and Road' progress.¹⁰ Success in attracting Southeast Asian investment into China is as critical as that entering the former's markets, as it takes a web of two-way investments between any pair of economies to sustain the flows of business interests and societal goodwill.

In contemplating future prospects of connectivity between China and Southeast Asia, two conceptual issues stand out. Neither is new but each deserves continuous attention in research and analysis.

Strategic choking points. The Straits of Malacca is often identified as a geostrategic source of vulnerability for China, especially against the background of China continuing to import oil from the Persian Gulf across the Indian Ocean and South China Sea. Alarm-generating headlines, though mainly in academic journals, repeatedly ask if denying Chinese access to oil imports at sea can be a realistic policy option.¹¹ Partly because China went through two decades of blockade by the United States and its allies in the wake of the Korean War, Chinese analysts are understandably alarmed.

On the other hand, rhetoric about a 'Malacca Dilemma' facing China fails to take into consideration that modern weaponry allows destruction/interdiction at any point on earth. Should a China-related object be so identified, it needs not be restricted to oceanic locations. Nor would it be restricted to a location under the legal jurisdiction of another country. A strait is just a little bit more beneficial in that the offensive party can cut its operational costs. A maritime strait does hold the potential for its littoral state(s) to use it as an opportunity for bargaining with user states. For example, it can consent to action against the interests of a third party. But such gamesmanship will inevitably come with costs of its own kind.

The criterion for assessing the value of China-funded projects such as Malaysia's East Coast Rail Link¹² and the Melaka Gateway¹³ should be strictly related to the economic development of the adjacent areas of Malaysia. Those projects, when successfully executed, may contribute to strengthening trade and investment between the Malaysian and Chinese economies, each of

which is in turn global by nature. The same holds true for Chinese-invested ports and roads in Cambodia¹⁴ and other ASEAN economies. Failure to deliver economic dividends will render any further talk about the extended significance of these projects irrelevant.

Furthermore, the host government and society shoulders as much responsibility as China does in working to undo the myths about non-economic aspects of the projects in question. After all, China came to involve itself on the basis of local proposition and acceptance in the first place.

The bottom line is that conceptualization of a large infrastructure project in a Southeast Asian country should NOT be based on using – even implicitly – any sort of Malacca-as-a-choking-point rationalization. Rather, whether it is a newly built or an upgrading of a maritime port, railroad or highway, what is important is the hinterland linkage, especially the prospects of industrialization and urbanization such an infrastructure can generate. The greater its hinterland linkage, the worthier a port/road project.

Debt Levels. How one country should appropriately deal with its financial indebtedness to another country is an age-old challenge for both the lending and borrowing parties. The process is economically consequential as it can have explosive domestic political implications. The postwar history of creditor-debtor relationships is filled with controversies over one party accusing the other of getting it into a trap. By the late 1980s, aid fatigue was pervasive among the lending states and multilateral lending institutions.¹⁵

In a country-to-country debt situation, the creditor certainly has self-interest in making its offer. Granting or extending a loan – either at interest rates lower than those by other lenders or with long repayment periods, or both – more often than not is tied to the borrower's agreement to purchase specified products and services.

The Hambantota Port in Sri Lanka, incidentally, has come to be identified as a symbol of the 'debt trap' China's pursuit of connectivity by infrastructure can get a participating country into. As is frequently pointed out, by the end of 2017, China and Sri Lanka had entered into an equity swap arrangement, which included the lease of an 80 percent stake in the port to the Chinese company for 99 years.¹⁶ To be sure, for both the Chinese and Sri Lankan entities involved in planning and advising government actions on the port, a lot of reckoning is due. After all, Chinese involvement in the project reportedly dated back to 2011 and there were numerous warnings along the way against the speed and scale of the project.¹⁷ One alternative – let me emphatically say that this should not be misread as a threat, as it would be a normal choice of action in the business world – would be for the Chinese company to take the loss and terminate its involvement in the whole project. Instead, the Chinese company remains committed to bringing into fruition logistics, industrial zones and other projects adjacent to the port. Without doubt, both Sri Lankan and Chinese entities involved have the same task to prove skeptics wrong by focusing on the economic viability of any new undertaking.

It is useful to note that Hambantota is not the only port development project Chinese companies are involved in in Sri Lanka. In the Colombo port area, a China-funded \$1.4 billion city project,

which was rebranded as the Colombo International Financial City in 2015, is proceeding with much less fanfare.¹⁸ This is indeed welcome news, as such an investment from China can help enhance the economic vitality of a mature port in Sri Lanka.

In any case, the debtor is not as vulnerable and helpless as frequently portrayed in the popular media. When debt repayment risks fall behind the original schedule, negotiations toward debt re-scheduling and even forgiveness can take place. One other option is to declare default. Such are standard practices. In dealing with the intricate aid politics, China is fairly new and has much to learn before it can master the fine arts of debt (re)arrangement.

Of greater significance is the quality of consultation between the two parties over projects that a particular debt is used to finance. Both the creditor and the debtor shoulder an equal share of responsibility. In other words, a more responsible way in discussing the financial aspect of country-to-country connectivity is debt discipline.

CONCLUDING OBSERVATIONS

Measured by both volume of stock and flow of foreign direct investment into Southeast Asia, China ranks low on the scale.¹⁹ In contrast, China receives a disproportionately high level of media attention in the region and beyond, much of which is of a negative nature. Though not dealt with in detail in this research note, China itself went through similar phases in the mid- and late-1980s when the contrast between foreign and domestic economic presences in its society was particularly sharp. Therefore, there is little that is inherently abnormal about the current state of affairs.

This note has highlighted notions of strategic choking points and debt levels as entry points for discussing the current state of sentiments about Chinese involvement in infrastructure projects in the region, as they stand out as the ones that drive support for extreme ends of thinking. Many other issues, such as associated labour movement and skill diffusion that come with the investment projects are just as significant, although a discussion of them would require a separate piece of writing.

In conclusion, the central message I hope to convey is that connectivity is a two-way process and a worthy goal, if often a bit protracted. When vested interests conduct good-faith collaboration, enhanced connectivity has a greater chance to prevail, as it should, due to laws of economic geography.

¹ Julian Kirchherr, “Strategies of Successful Anti-Dam Movements: Evidence from Myanmar and Thailand,” *Society & Natural Resources: an international journal*, 31:2, pp. 166-182.

² Laur Kiik, “Nationalism and anti-ethno-politics: why ‘Chinese Development’ failed at Myanmar’s Myitsone Dam”, *Eurasian Geography and Economics*, 57:3, 2016, pp.374-402.

³ This dam, perhaps due to its remote location and small size, is seldom referenced in descriptions about China's hydropower stations. See Cheng Xuemin, "China's First World Bank Assisted Hydro Scheme", *International Water Power in Dam Construction*, 38:2, 1986, pp. 41-44.

⁴ "China: Lubuge Hydroelectric Project", World Bank Staff Appraisal Report, January 23, 1984. <http://documents.worldbank.org/curated/en/762551468015015114/China-Lubuge-Hydroelectric-Project>

⁵ This edited volume is a showcase of how the electric power industry made use of foreign input countrywide. 张基尧, 《涉外水利水电工程建设实践与探索》, 黄河水利出版社, 2004年。

⁶ Zha Daojiong, "A Political Ecology of Hydropower Development in China", in Nathaniel Matthews and Kim Geheb, editors, *Hydropower Development in the Mekong Region: political, socio-economic and environmental perspectives*, Routledge, 2014, pp. 32-53.

⁷ A fuller expose about Chinese learning from Southeast Asia can be found in Zha Daojiong and Hu Weixing, *Building a Neighborly Community: post-Cold War China, Japan and Southeast Asia*, Manchester University Press, 2013, chapter 1.

⁸ Lu Jianren, "The 21st Century Maritime Silk Road and China-ASEAN Industry Cooperation", *International Journal of China Studies*, 7:3, 2016, pp. 375-392.

⁹ China International Import Expo, http://english.mofcom.gov.cn/article/zt_englishimport/index.shtml

¹⁰ 国家统计局公布“一带一路”成绩单, <https://www.yidaiyilu.gov.cn/xwzx/gnxw/49232.htm>

¹¹ Gabriel Collins, "A Maritime Oil Blockade against China: tactically tempting but strategically flawed", *Naval War College Review*, 71:2, 2018, pp. 49-78. Llewelyn Hughes and Austin Long, "Is There an Oil Weapon?: Security Implications of Changes in the Structure of the International Oil Market", *International Security*, 39:3, 2014/15, pp. 152-189. Gabriel Collins, "No Oil for the Lamps of China?" *Naval War College Review*, Spring 2008, 61:2, 2008, pp. 79-95.

¹² Land Public Transport Commission, Malaysia, East Coast Rail Line (ECRL) Project, <http://www.spad.gov.my/land-public-transport/rail/east-coast-rail-line-ecrl-project>

¹³ Melaka Gateway, <http://melakagateway.com/>

¹⁴ Vannarith Chheang, "Cambodia Embraces China's Belt and Road Initiative", *ISEAS Perspective*, #48. https://www.iseas.edu.sg/images/pdf/ISEAS_Perspective_2017_48.pdf

¹⁵ Cheryl Payer, *Lent and Lost: Foreign Credit and Third World Development*, Zed Books, 1991.

¹⁶ "Sri Lanka hands over running of Hambantota port to Chinese company", *South China Morning Post*, December 10, 2017, <https://www.scmp.com/news/china/diplomacy-defence/article/2123658/sri-lanka-hands-over-major-port-chinese-company>

¹⁷ Nilanthi Samaranyake, "Are Sri Lanka's Relations with China Deepening? An Analysis of Economic, Military, and Diplomatic Data," *Asian Security*, 7:2, 2011, in particular, pp. 126-131.

¹⁸ "New Sri Lankan Port May be a Key Link between India and China", *Asia Times*, August 17, 2018. <http://www.atimes.com/article/new-sri-lankan-port-may-be-a-key-link-between-india-and-china/>

¹⁹ For a sketch of China's standing in FDI into ASEAN, see page 4 of *ASEAN Investment Report 2017* at <http://asean.org/storage/2017/11/ASEAN-Investment-Report-2017.pdf>

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