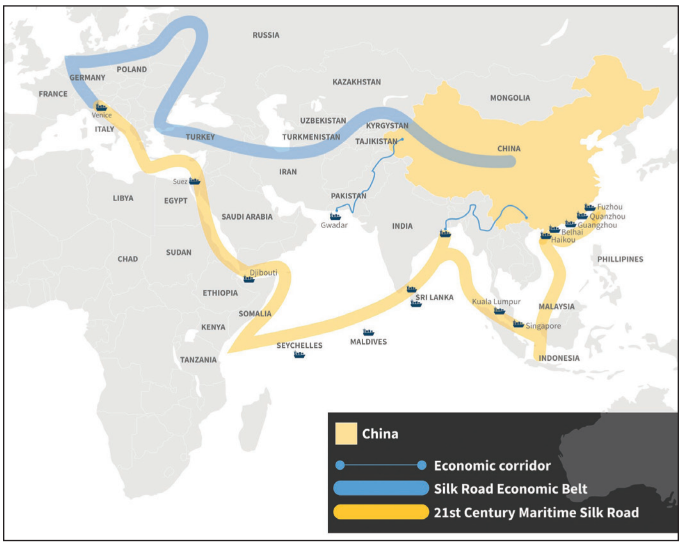
Understanding China’s Belt and Road Initiative and its Implications for Malaysia

Malaysia has been supportive of the Belt and Road Initiative since its inception. China reciprocated with a spate of investments notably from market leaders such as Hua Wei, Alibaba, CRRC Zhuzhou Electric Locomotive Co., etc. The RM55 billion East Coast Rail Line awarded to and financed by China is a typical infrastructure project under the Belt and Road Initiative.

Malaysian businesses must understand what is the Belt and Road Initiative in view of its far-reaching impact on the world economy, and its implications for Malaysia.

International Economic Cooperation Platform

On September 7 2013, President of China, Xi Jinping put forward the concept of “Silk Road Economic Belt” while giving a speech at Nazarbayev University during his official visit to Kazakhstan. The following month, he mooted the idea of “21st Century Maritime Silk Road” when addressing the Indonesian Parliament. The two proposals are known collectively as the Belt and Road Initiative (BRI) or One Belt One Road (一带一路) in Chinese.



The Belt and Road Initiative encompasses 64 countries across Eurasia and Africa, which account for 43.4% of the world population (3.21 billion) and 16% of global GDP (USD $12 trillion). These figures significantly increase to 61.9% of world population and 30.9% share of global GDP if China is included.

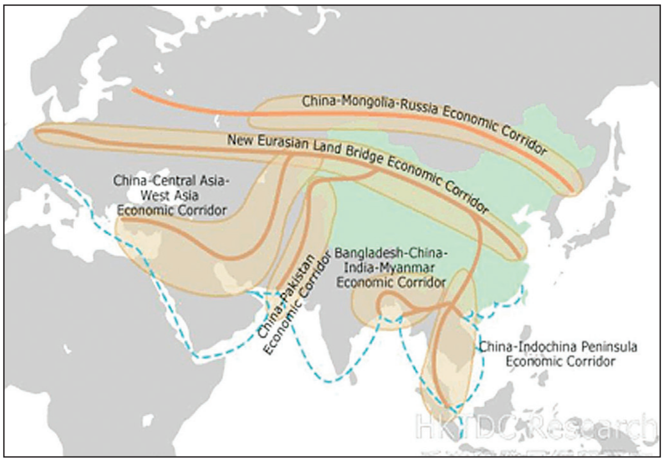
The Belt and Road Initiative (BRI) aims at enhancing infrastructure connectivity and boosting trade and investment of Eurasian countries, spanning from China’s west through Central Asia to Europe.

The Belt and Road Initiative is not an entity, neither a mechanism. It is an open and inclusive platform for international economic cooperation, geographically covers but not limited to countries along the ancient Silk Road. Simply put, **BRI is a massive transnational economic cooperation blueprint for growth and development for Eurasia proposed by China.**

Silk Road Economic Belt

Six economic corridors are to be developed in the overland Silk Road Economic Belt, along the three international passageways that connect (1) China to Europe through Central Asia & Russia (2) China to Middle East through Central Asia and (3) China to Southeast Asia & South Asia. The six economic corridors are:

- China-Mongolia-Russia Economic Corridor
- New Eurasian Land Bridge Economic Corridor
- China-Central Asia-West Asia Economic Corridor
- China-Indochina Peninsular Economic Corridor
- China-Pakistan Economic Corridor
- Bangladesh-China-India-Myanmar Economic Corridor



21st Century Maritime Silk Road

The ocean-going 21st Century Maritime Silk Road envisions two secure, efficient and unhampered sea transportation routes connecting the seaports along the Belt and Road. It begins from China's eastern seaboard to Europe through South China Sea and Indian Ocean in one direction, and to the South Pacific in the other.

A New Paradigm for International Economic Cooperation

BRI represents a new paradigm for international economic cooperation proposed by China. It draws inspiration from the Silk Road Spirit, i.e. peace and cooperation, openness and inclusiveness, mutual learning and mutual benefit. As paraphrased in the Vision and Action Plan, "mutual consultation, joint development and shared benefits" are the guiding principles of BRI.

Implementation of BRI will abide by international norms and market practices, with enterprises playing the primary role in resource allocation and risks taking, and governments performing their due functions.

Synergising on economic complementarities, countries with different resource endowments could take part in BRI in manners and forms that best suit their development needs and priorities. BRI aims ultimately at creating "a community of shared interests, responsibility and destiny" with strengthened connectivity and deepened economic integration of the region.

5 Key Areas of Cooperation

The main focus of BRI is to promote economic cooperation through infrastructure connectivity and enhance trade flow and investment opportunities by reducing transnational transaction costs and barriers. Five key areas of cooperation are identified.

❶ Policy Coordination

Policy coordination refers to intergovernmental consultations and the building of multilevel macro policy exchange and communication mechanisms. Such intergovernmental engagement strengthens political trust and expands shared interests. Partner countries could align and adjust their development strategies to match that of BRI in order to draw greater benefits from their participation. How Pakistan aligns its development strategies under "Pakistan 2025", which aims to make Pakistan "The Next Asian Tiger", is a showcase example of Policy Coordination.

❷ Infrastructure Connectivity

Infrastructure connectivity is the top priority of BRI. Economic development in many BRI countries is hampered by weak infrastructure facilities. On the other hand, China's is well-equipped with technological expertise and capabilities in constructing railways, highways, tunnels, bridges, ICT facilities, oil and gas pipelines, power plants and seaports. BRI aims to build extensive networks of sea and land transportation, telecommunication facilities, pipelines, power grids, etc., to drive economic growth in the region.

BRI presents a seamless match of China's strengths and the infrastructure needs of the developing economies in the region.

❸ Trade and Investment Enhancement

Trade facilitation and removal of investment barriers are crucial areas of cooperation under BRI. The BRI corridors will generate higher benefits if partner countries lower cross border transaction costs and import tariffs through such measures as speedy custom clearance, sharing of shipping information, mutual recognition of certifications and regulations, etc.

Signing of bilateral investment guarantee agreements and double taxation avoidance agreements and removal of investment barriers would create conducive business environment. E-commerce and other forms of investment that could take advantage of infrastructure and ICT connectivity are encouraged.

❹ Financial Integration

Bilateral currency swap arrangements could reduce exchange rate risk and transaction costs for trade and investment. China has so far signed 21 bilateral currency swap agreements with BRI countries, including Malaysia. Meanwhile offshore Renminbi bonds are encouraged as alternative means of financing mega BRI's infrastructure projects. Both measures would expedite internationalisation of Renminbi and strengthen financial and economic linkages amongst Eurasian countries.

The Asia Infrastructure Investment Bank (AIIB), which was officially launched in 2015 by China, attempts to complement the role of existing multilateral development banks (MDBs), with initial focus on providing financing for BRI. It has now 77 members with a capital of $100 billion, of which China holds 30.34%. BRI's huge financing needs could further be met by China's $40 billion Silk Road Fund (China pledged additional RMB1000 billion for the Silk Road Fund during the Belt and Road Forum for International Cooperation), policy and commercial banks, or co-funding from the other MDBs such as the New Development Bank, ADB and the World Bank.

❺ People-to-People Bond

The ancient Silk Road is not only a trade route but also a conduit for cultural exchange. It began from China, but is the common heritage of all peoples along the Road. Similarly, though a China initiative, benefits of BRI will be shared by all countries that have taken part in this international economic cooperation endeavor of an unprecedented scale.

BRI attempts to revive the ancient Silk Road Spirit of "peace and cooperation, openness and inclusiveness, mutual learning and mutual benefit" through cultural and academic exchanges, tourism, sharing of information on healthcare and poverty eradication and cooperation in science and technology, etc. Such exchanges between people would foster bonds and understanding, galvanising trust and support of the people for the expeditious implementation of BRI.

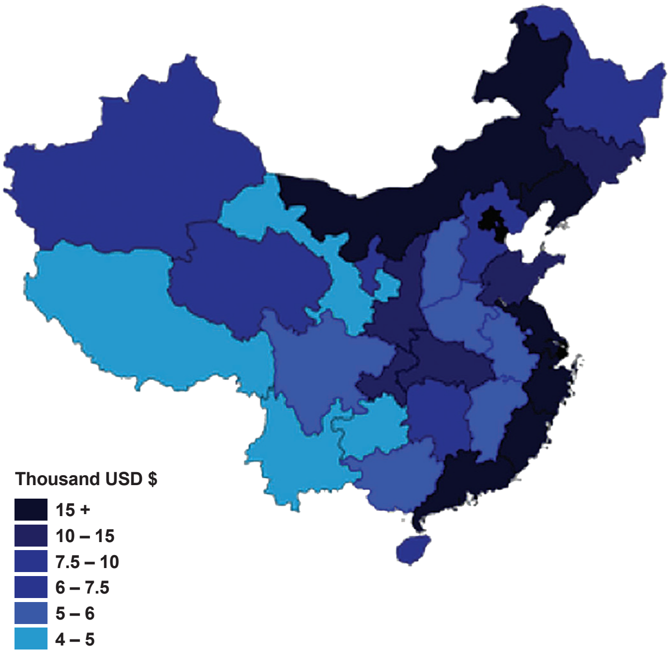
Restructuring China's Economy Through Further Integration with the World

Though some analysts view it as a diplomatic offensive with geopolitical motives, China's BRI is primarily driven by its pressing needs to transform its national economy through further integration with the world. China's phenomenal rise in economic power, especially after joining WTO in 2001, speaks volumes of how it has benefited from globalisation and free trade. BRI is China's continued globalisation effort intricately woven with its quest for structural reform of the economy.

Rebalancing Regional Economic Development

Glaring regional economic disparity has been an overriding concern of the Chinese government. As shown below, after close to four decades of economic modernisation, per capita GDP of China's eastern coastal provinces have exceeded USD$15,000, while that of the northwest provinces were just half or less. BRI effectively turns around the focus of China's

Chinese administrative divisions by nominal GDP per capita in USD $ (2014)

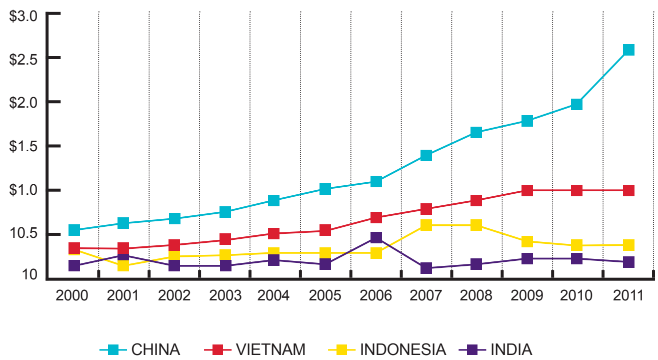


economic development from east to west, as the landlocked western hinterlands are now connected to Central Asia, Middle East and Europe through a network of rail and overland roads. Access to the Indian Ocean is now made possible through the China Pakistan Economic Corridor. BRI is expected to unleash the economic potentials of the west, thus revitalising the underdeveloped provinces.

Moving Up the Manufacturing Value Chain

China has lost its low-cost competitiveness as wages in the manufacturing sector tripled over the last ten years. To remain competitive, China has to move up the world's manufacturing value chain and at the same time relocate its labor-intensive industries to countries with cheaper wages.

BRI opens up such opportunities as many countries in the region have abundant labor supply and are ready markets for its high value products such as high-speed rail and nuclear power plants. While previously deemed impractical, improved infrastructure facilities and connectivity under BRI render such moves feasible and laudable.

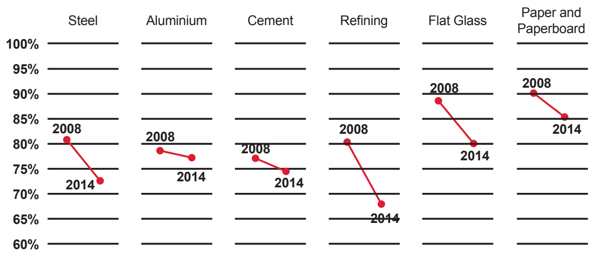


Average hourly wage, China, Vietnam, Indonesia and India 2000 – 2011
Source: Accenture, 2011

Addressing Excess Industrial Capacity

One of the fallouts of China's RMB 4 trillion stimulus package launched in 2008 to minimise the impact of global financial crisis was the aggravation of excess capacity in industries such as steel, cement, coal, aluminum, etc. China expects demand from mega infrastructure projects under BRI would help to partially absorb overcapacity in these industries.

Utilisation rates for six industries



As the chemical industries covers an extremely wide range of products and quantifying capicity in the shipbuilding industry is highly complex for the sake of clarity these two sectors have not been included in this chart.

China Pakistan Economic Corridor

Portrayed as a "game-changer" by some analysts, the China Pakistan Economic Corridor (CPEC) merits special mention as it is the flagship project of BRI, enormously important to China and Pakistan in particular, and countries in Central Asia at large. China has committed to invest $46 billion in CPEC, but latest report indicates total investment will now exceed $60 billion with over 50 countries expressing their interests in the project.

With the construction of Qwadar Port, a transhipment hub developed and managed by China, CPEC opens a passageway for the landlocked Central Asian countries to the Indian Ocean/ Arabian Sea. It also serves as a backdoor for China as it connects Xinjiang Province directly with overland highway and eventually rail links. Theoretically, this could cut sea journey of oil shipments from Africa/Middle East to the east coast of China by as much as 85%, bypassing the dilemmatic Straits of Malacca.

Implications for Malaysia

As an open economy with strategic location, Malaysia is well poised to benefit greatly from BRI. A quick review of its implications to Malaysian businesses is both imperative and timely.

Long term Implications

- Momentum shift of world economy from West to East, as China becomes world's largest economy earlier than many expected due to contributions from BRI.
- Reconfiguration of world logistic and supply chains as a result of infrastructure connectivity and growth of Eurasian economies.
- Greater importance of "China content" in our economy due to factors mentioned above and increased presence of China's investments, from trade, transportation to manufacturing and tourism.

Short Term Implications

- Capitalising on Malaysia's Muslim country status as close to half of the BRI countries are with Muslim majority population.
- Malaysian labor intensive industries could tag along China to relocate their manufacturing facilities to BRI countries with abundant labor supply.
- Explore market potentials in Central Asian countries that are expected to benefit tremendously from BRI, particularly CPEC of Pakistan.
- Malaysian SMEs should take advantage of the opportunities available under e-commerce platforms promoted under BRI. Improved connectivity of transportation and internet facilities would give further growth impetus to borderless e-commerce.
- Spillover effects of mega infrastructure project under BRI.

Conclusion

Malaysia has been China's biggest trading partner in Asean consecutively for seven years until 2016 when Vietnam took over its position. China is now Malaysia's largest foreign investor. As economic protectionism is on the rise in Western countries, particularly in USA, China is inevitably set to play an increasing role in Malaysia's economic life.

China's rise is "a return to the natural order of things", commented Australian Prime Minister Malcom Turnbull on China's global role in the 21st century. The same could be said of the close economic relationship between Malaysia and China under Belt and Road, as both countries had trade ties dating back thousand years ago, in the days of ancient maritime Silk Road!

KOH KING KEE is the director of the Baker Tilly (Malaysia) – China Road and Belt Desk. This article was prepared based on information available generally and is not intended to be relied upon as professional advice. For further information, please email to **kohkingkee@bakertillymh.com.my** or visit **www.bakertillymh.com.my**