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China's Belt and Road Initiative (BRI) and Southeast Asia

October 2018

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Contributors

PROFESSOR MICHAEL COX is Director of LSE IDEAS and Emeritus Professor of International Relations at LSE. He is a renowned international lecturer who has published extensively on the United States, transatlantic relations, Asia's rise and the problems facing the EU–and the impact these changes are having on international relations.

TAN SRI DR MUNIR MAJID is Chairman of CIMB ASEAN Research Institute, and also of Bank Muamalat Malaysia, of the Financial Services Professional Board, of ASEAN Business Advisory Council, Malaysia, as well as President of the ASEAN Business Club. He sits on the board of the Institute of Strategic and International Studies (ISIS), is an Honorary Fellow of LSE and Visiting Senior Fellow LSE IDEAS. He is an active regional advocate of deeper ASEAN economic integration.

DR YU JIE is Head of China Foresight at LSE IDEAS. Her research focuses on the decision-making process of Chinese foreign policy as well as China's economic diplomacy. She speaks and writes frequently at major media outlets such as the BBC, the Financial Times and the Washington Post. She also regularly briefs China's geopolitical landscape to senior policy practitioners and corporates, including the UK Cabinet Office, the Silk Road Fund in Beijing, Royal Dutch Shell and the UBS. Dr Yu has been recognised as "a Leading Woman of LSE".

JINNY YAN is Managing Director, Chief China Economist, China Markets Strategy, Global Markets Fixed Income, Currencies, and Equities, ICBC Standard Bank. Prior to joining ICBC Standard Bank to lead China markets strategy and research, Jinny was a London-based Senior Economist at Standard Chartered Bank. She covered key China-Europe macro topics with a focus on Renminbi internationalisation. Her previous economist roles include covering China based in Shanghai, Europe, and supporting the Chief Economist.

SUFIAN JUSOH is Director of the Institute of Malaysian and International Studies (IKMAS), Universiti Kebangsaan Malaysia. Sufian is also a Senior Fellow at the CIMB ASEAN Research Institute. He is a co-founder of the ASEAN Economic Integration Forum and retains his affiliation at the World Trade Institute, Switzerland and the World Bank Group.

HANIM HAMZAH is Regional Managing Partner of ZICOlaw Network, the only premier law firm network with offices in all ten ASEAN countries. The network comprises independent leading law firms with a full presence in 18 cities across Southeast Asia, a region of over 600 million people and 10 countries. Research support by team led by Norlaila binti Mohd Nasir of ZICO Knowledge Services Sdn Bhd. She is also Senior Fellow of the CIMB Institute.

DR NICOLA CASARINI is Senior Fellow at the Istituto Affari Internazionali (IAI) and Visiting Professor at the Graduate Institute in Geneva. He is a non-resident Global Fellow at the Wilson Center in Washington DC. Prior to this, he held positions at the Wilson Center in Washington DC, at the EU Institute for Security Studies in Paris; at Bocconi University in Milan; at the European University Institute in Florence; and at the London School of Economics (LSE).

PAULINE LOONG is managing director of the Hong Kong-based research consultancy Asia-analytica. She is also a Senior Fellow of CIMB ASEAN Research Institute. She has earned an outstanding reputation as among the best-informed analysts of China's political economy. She authors the well-known "Loong on China" newsletter which has won accolades for its perceptiveness as well as its meticulous research and reliability.

KELVIN TAY is Regional Chief Investment Officer at UBS Global Wealth Management. Kelvin is a member of the UBS Global Emerging Markets Investment Committee, as well as the Asia-Pacific Investment Committee where he provides strategic research and inputs to the investment and asset allocation process across asset classes.

DR THITINAN PONGSUDHIRAK is Director of the Institute of Security and International Studies (ISIS) and Associate Professor of International Political Economy at the Faculty of Political Science, Chulalongkorn University. He has authored and lectured on a wide range of articles, books and book chapters on Thailand's politics, political economy, and foreign policy, and ASEAN and East Asian geopolitics and geoeconomics.

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CHINA'S BELT AND ROAD INITIATIVE (BRI)
AND SOUTHEAST ASIA
October 2018

Preface

Whether or not one calls it the new 'Silk Road' , 'One Belt One Road', the 'Belt and Road Initiative', or even just by its acronym–'BRI'–there is little doubt five years after President Xi Jinping initially championed this 'project of the Century', that it has assumed enormous importance: first for China itself for whom it has become the centrepiece of its foreign policy strategy; secondly for the wider Eurasian region including of course Russia and Central Asia; and finally for the ASEAN countries themselves. For Southeast Asia as a whole the 'BRI' presents enormous economic opportunities. Yet, as a number of the contributors here point out, there are some really big challenges too. If one can, to use the jargon, improve 'connectivity' with infrastructure development, then all well and good. Everyone will be a winner. On the other hand, if China simply uses the BRI - as one of the contributors here fears it might - to ensnare countries into dependent and unequal relationships, then some difficult days lay ahead. Few would question China's right to having a seat (and a very big one at that) at the high table of international politics. Indeed, some would insist that in the absence of American leadership, the only option now is for China to take the lead. The key question, then, is not should it lead: it is bound to (to paraphrase Nye), but rather how well will it do so in the years ahead? As the joint editor of this informative report astutely points out, reactions to the BRI outside China have been mixed to say the least, ranging from admiration at one end of the spectrum to fear and suspicion at the other. It must be in everybody's interest–including China's–to recognize this and do everything possible to ensure that the BRI does not just become a win for one country, but instead a success for all. President Xi has called the BRI project "a road for peace" which will not be shaped by "outdated geopolitical maneuvering." We must all hope that he is right.

Professor Michael Cox
Director
LSE IDEAS

China and Southeast Asia: Many Belts and Roads to turn

Yu Jie

Five years since its launch, China's Belt and Road Initiative (BRI)–which aims to fund and build infrastructure in more than 78 countries–is riding both high and low. No other developmental initiative has stirred so much international debate. Reactions from academics, policymakers, and entrepreneurs range from fear to admiration.

Much of the discussion of BRI is focused on President Xi Jinping's 'new' and 'proactive' approach to foreign affairs, in stark contrast to his predecessor President Hu Jintao's 'risk-averse' style. However, BRI is also true to Deng Xiaoping's essentially conservative maxim on the aims of Chinese foreign policy: "to create a stable external environment for China's domestic economic growth".

As a result, participation from countries in Southeast Asia is pivotal to the success or failure of Beijing's ambitious undertaking.

Beijing has already realised that its passion for BRI may be unrequited internationally, partly because the programme includes serious risks and not just rich returns.

Recent disputes on the implementation of BRI between China and other Southeast Asia countries show that China should not automatically assume that growth through gigantic infrastructure investments–the model that worked for China–is a panacea applicable everywhere.

This does not mean that China's BRI is only about building railways, airports and shipping docks.

This joint report published by LSE IDEAS and the CARI ASEAN Research Institute in Malaysia explores the range of impacts of the BRI on Southeast Asia. The BRI brings opportunities in trade, engineering and in finance, particularly in supporting the internationalisation of the Renminbi. But it also poses serious and fundamental challenges to the existing international legal framework, in relation to both commercial and political disputes. The BRI also impacts on foreign policy. Many Southeast Asian countries face the dilemma of being eager BRI participants and traditional US allies, unsure with which superpower to side on issues such as the South China Sea and international trade wars. After 40 years of economic reform at home and a bold opening to the global economy during the 1990s, China is again at the crossroads and asking itself where it might be heading. President Xi has explicitly linked the pursuit of BRI to his own domestic economic reforms, focused on the market allocation of resources, and it is central to China's plans to geographically rebalance its economy. In this and other ways, the initiative is crucial to the country's future.

It may be unlikely that China will alter the BRI's trajectory based on criticism and feedback from its neighbours. But Beijing must maintain a close understanding of how countries across Southeast Asia are reacting to the BRI, and respond to their concerns. The challenge for China going forward is as much about winning hearts and minds as it is showering dollars and pounds.

But before we can arrive at any firm conclusions about the success or failure of the BRI, progress and activities so far must be studied. This joint report is part of a much wider conversation about which "Belt" and "Road" do China and the world want. ■

The Belt and Road Initiative in Southeast Asia

Jinny Yan

> Future success depends on the dynamism of policy targeted to engage both the public and private sectors with all three dimensions of economic connectivity with China.

Five years after it began, if you had to summarise the BRI in one word, ‘connectivity’ would be it. But it is more than just the common one-dimensional view of connecting countries by hard infrastructure.

Economies that are well-connected are those which have a high degree of exchange of both the inputs into economic activity and the outputs from economic activity. Therefore connectivity between countries (not just countries with BRI related agreements in place) needs to be three-dimensional in order to deliver economic value for the local and international economy. These dimensions are (1) the cross border flow of goods and services, (2) capital, and (3) people. In the context of BRI, economies most active in all three dimensions of economic connectivity are likely to benefit the most from the initiative.

TRADE

The first dimension is trade. China’s supply chain connectivity has risen across BRI regions over the past decade, but ASEAN economies remain the most connected. This is likely to reflect a continuation of outsourcing to China from high-cost economies in the region, such as Singapore and Malaysia, while Chinese firms themselves outsource lower value-added processes to the region’s cheapest economies such as Cambodia and Laos. Meanwhile, supply chain connectivity has also deepened across other BRI regions. The Former Soviet Union and South Asia regions are now almost as connected to Chinese suppliers as ASEAN economies were in 2005.

Singapore, Vietnam, Thailand, Malaysia, Cambodia, and Myanmar are all ranked amongst the top ten most connected to China via trade,[1] and China continues to deepen trading relations with partner economies in Southeast Asia. The Free Trade Agreement (FTA) with ASEAN was the first of its kind, between China and a regional organisation, and was upgraded in 2014 as part of the BRI. Trade and investment flows have accelerated since this upgraded agreement came into effect in 2016. Several underlying dynamics are crucial in this respect.

For particularly low-cost economies, outsourcing from China has been fundamental. Growth in Chinese trade with Vietnam (up an impressive 25% in nominal US$ in 2016) has been driven by outsourcing the most cost-sensitive parts of electrical and machinery assembly, while food processing is a key sector for Cambodian trade with China, and Myanmar is cooperating (and indeed competing) with Chinese clothing manufacturers. China's increasingly challenging demographics, and ever rising wage costs, mean that these channels of trade connectivity are likely to deepen in the years ahead.

Higher income economies in the region act as key inputs to China's manufacturing itself. For example, Malaysia's position at the cutting edge of microchip production means it supplied China with US$16bn worth of integrated circuits in 2016, second only to Korea in this respect. Singapore's role as a global trade hub slightly complicates an assessment of the role domestic production plays in its exports to China, but again inputs to Chinese manufacturing predominate, including around US$7bn in chemicals, plastics, and rubber products. Both Malaysia and Singapore will likely become increasingly important as China's manufacturing shifts into higher value-added sectors.

The full impact of 'trade war' is yet to be reverberated globally. However, uncertainty over policy action and reaction has been the most destabilising common denominator causing jitters across global markets. The most vulnerable economies include Cambodia, Singapore, Vietnam, Thailand, and Malaysia. These are open economies with export markets worth at least 70% of their GDP. They are strongly integrated into global supply chains, which could be disrupted by trade tariffs imposed.

CAPITAL

The second dimension is capital. In a nutshell, this involves direct investment, portfolio investment, and official investment. Before 2013, China's capital connectivity was focused on commodity-exporting economies because its priority was securing raw materials for domestic industrial activity.

In more recent years, capital connectivity with higher value-added economies has become more important. Rather than accessing materials, China is increasingly focussed on accessing technology. Thus, China's role as an outbound investor has become increasingly important. Indeed, China has been a net exporter of capital since 2016. This is not necessarily entirely triggered by the BRI, but is driven by the current stage of China's economic development cycle.

Unlike trade, capital–especially portfolio flow–is difficult to quantify. Despite the sprawling size of the BRI, no publicly available official data source keeps tally of all these investments. As a result, much of the available information is qualitative. In our analysis of 88 BRI countries,[2] we estimate that over 1,100 investment projects were announced or are underway, worth more than a total of US$750bn, that can be considered BRI projects. These include infrastructure construction projects in BRI countries with Chinese involvement in financing, construction, or operating capacity, and Chinese investment directly into companies through merger and acquisitions.

The transport and logistics sector has by far the highest concentration of BRI investments, with roughly US$330bn of tracked projects in the 88 countries we follow. The energy and utilities sector has attracted the second most investment since 2013, at US$266bn. These two sectors together represent more than three quarters of the tracked total and are what are typically considered as the mainstay of the BRI.

Within transport and logistics, railways have attracted the highest value of investment at just under US$190bn. Road and automotive projects is the next largest sector with a total investment of US$66bn, followed by ports and shipping category at US$39bn, the majority of which is investment in new or expanded harbours and port facilities.

There are only a handful of projects investing in infrastructure to facilitate intermodal trade (transport of goods using multiple modes of transportation) and very little investment in aviation.

Other tracked investments are spread across sectors less directly associated with public infrastructure projects, including heavy industry, technology and finance, real estate, and tourism. Within technology and finance, the largest investments come from Chinese entities into businesses in developed markets such as Singapore. Notable examples include a consortium of Chinese investors purchasing a Singaporean semi-conductor manufacturer.

Amongst ASEAN member countries, Indonesia (US$171bn), Vietnam (US$152bn), Cambodia (US$104bn), Malaysia (US$98bn) and Singapore (US$70bn) are the countries seeing the largest BRI related capital flow. (Appendix 1)

From an investment and project finance perspective, the reliability of the business climate and the risk of appropriation are central concerns when weighing up a foreign investment decision. In our comparative analysis of the same list of 88 BRI countries,[3] we find that Singapore is the highest ranked country in the BRI in terms of its business environment. The country's strong adherence to the rule of law and the transparency of its institutions have long underpinned one of the most successful development stories of the past 50 years. At the other end of the scale, some ASEAN countries such as Laos and Myanmar, together with Afghanistan, remain extremely problematic climates for investors. Many of the countries across Central and South Asia on the face of it look to be dynamic with strong growth prospects, but viewed in terms of their tax and regulatory regimes or the robustness of legal institutions, start to look less favourable.

Where businesses may be more hesitant, official financing of BRI related projects has played a significant role to date. Several investment vehicles, including Asian Infrastructure Investment Bank, New Development Bank, Silk Road Fund, and the Sino–Central and Eastern Europe Fund, have specific mandates to invest in BRI infrastructure projects. Chinese policy banks, namely China Development Bank and The Export-Import Bank of China, have also been active.

Whether the funding gap is US$4tr or US$8tr, the scale of financing required for BRI projects will be vast, and banks alone cannot be relied upon. According to the IFC (International Finance Corporation) the share of all infrastructure-financing in emerging markets coming from private sources was estimated at between 20% and 25%, with governments and development banks providing the rest. This contrasts with BRI projects to date where, according to our research, the share of tracked financing coming from private sources is less than 10%. In addition, it is large Chinese government-backed entities providing the majority of funding; other governments and multilateral development banks (MDBs) are estimated to have provided less than 10% of the total.

As such, generating interest from non-Chinese and third-party private sources remains a work in progress, though there are examples starting to emerge. With increasing demand from interested parties globally for enhanced transparency, risk mitigation, and environmental and social governance to be embedded into BRI project financing, joint cooperation with multilateral development banks is likely to be key for the future of BRI financing. The future will also involve new financing products to channel private assets, e.g. insurance and pension funds, towards BRI projects. This is where international financial centres such as Singapore and London will play an increasingly significant role in the BRI.

PEOPLE

The last dimension of economic connectivity is people–the flow of labour along BRI countries and direct social interaction e.g. tourism and educational exchange programmes.

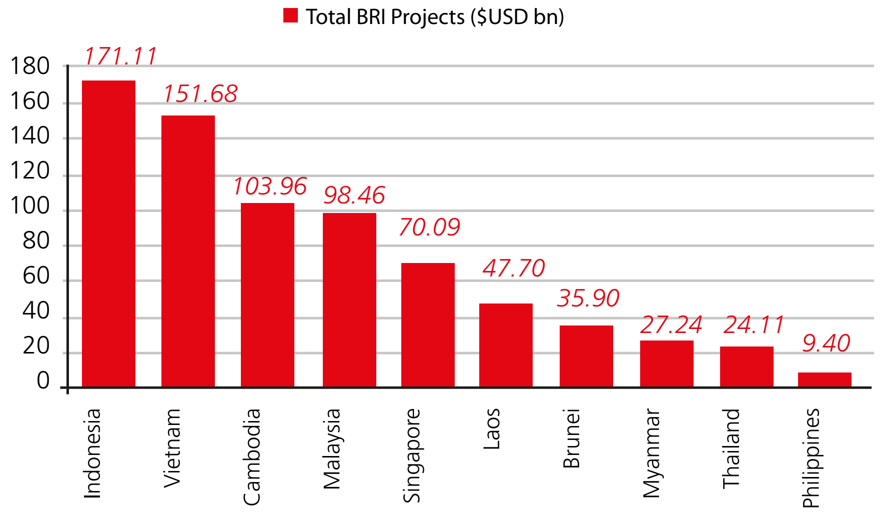
As hard infrastructure is thought to define BRI, soft infrastructure is often sidelined but it is equally important. An increasingly outward-looking Chinese population in search of education and tourism, plus a growing global appetite to visit China, have been key drivers in this respect.

Neighbouring countries in Asia-Pacific continue to demonstrate the strongest people connectivity with China, with deeper trade links increasing cross-border worker flows with key trade partners. Underlying drivers of people connectivity suggest this will be an increasingly important channel for connectivity in the years ahead.

CONCLUSION

Geographical proximity to China has served ASEAN and other neighbouring Asian Pacific countries well so far. Nonetheless, future success depends on the dynamism of policy targeted to engage both the public and private sectors with all three dimensions of economic connectivity with China. The BRI needs to be a catalyst for regional and global growth, not an excuse for China to seek further leverage. ■

APPENDIX 1. TOTAL BRI PROJECTS BY ASEAN MEMBER COUNTRIES



Source: Oxford Economics

APPENDIX 2. TOP 10 LARGEST BRI PROJECTS IN ASEAN

Rank	Year	Chinese Entity / Project	Cost US$	Sector	Subsector (where applicable)	Country of investment
1	2017	Kuala Lumpur–Kota Bahru Rail (Construction)	14,300,000,000	Transport	Rail	Malaysia
2	2013	Preah Vihear–Kaoh Kong Railway	9,600,000,000	Transport	Rail	Cambodia
3	2017	Vanke, Hopu, Hillhouse, Bank of China	9,060,000,000	Logistics		Singapore
4	Unclear	Kyaukpyu Deep Sea Port (Construction)	7,300,000,000	Transport	Posts/ Shipping	Myanmar
5	2015	China General Nuclear	5,960,000,000	Energy		Malaysia
6	2016	Vientiane–Boten Railway Project	5,800,000,000	Transport	Rail	Laos
7	2017	Bangkok to Nakhon Ratchisima High-Speed Railway (Phase 1)	5,352,905,500	Transport	Rail	Thailand
8	2013	Zhejiang Hengyi	3,440,000,000	Energy	Oil	Brunei
9	2017	China Railway Engineering	3,190,000,000	Transport	Rail	Indonesia
10	2017	China Railway Construction, China Railway Engineering	2,690,000,000	Transport	Rail	Thailand

Source: Oxford Economics

NOTES

1 CBCS CCI report September 2018 https://www.icbcstandardbank.com/CorporateSite/BRIThoughtLeadership

2 Interim Report via https://www.icbcstandardbank.com/CorporateSite/BRIThoughtLeadership

3 EHI report September 2018 https://www.icbcstandardbank.com/CorporateSite/BRIThoughtLeadership

The Impact of BRI on Trade and Investment in ASEAN

Sufian Jusoh

> BRI projects, coupled with internationally sourced financing including from China, help to increase the much needed investment in infrastructure projects in ASEAN.

Under the Belt and Road Initiative (BRI) China sees ASEAN as part of the land bridge connecting China to Southeast Asia, South Asia, the Indian Ocean, and the China-Indochina Peninsula Corridor sea route (China–South China Sea–Indian Ocean–Europe).[1]

On the other hand, ASEAN Member States regard the BRI as an avenue to improve connectivity with infrastructure development which will increase trade and investment in the region through improved logistics.

Hence, ASEAN Member States, in collaboration with Chinese entities (construction companies and funding agencies) are developing infrastructure projects, mainly through joint ventures.

BRI, ASEAN INFRASTRUCTURE NEEDS AND TRADE FACILITATION

ASEAN requires improved infrastructure to drive economic growth through increased trade, investment, competitiveness, and connectivity in the region and with the rest of the world. The ASEAN Development Bank (ADB) estimates that the total infrastructure investment needs in ASEAN from 2016 to 2030 will be between US$2.8tr (baseline estimate) and US$3.1tr (climate-adjusted estimate).[2]

These infrastructure needs are important to support the increasing amount of ASEAN trade, with total merchandise trade increased from US$4tr in 2010 to US$5tr 2017.[3] The total merchandise trade is expected to increase as ASEAN grows from the sixth largest economy in the world to the fourth largest economy in the world by the year 2050, with an annual expected GDP growth of 5.25% between 2016 and 2020.[4]

TABLE 1: BRI PROJECTS IN ASEAN 2013–2018

Source: Author tabulates the Table based on the data from the Center for Strategic and International Studies and ***Nikkei, Is China's Belt and Road Working?*** A progress report from eight countries Beijing's infrastructure push clouded by project delays and mounting debt, 28 March 2018.

No	Project Name	Type	Start (expect)	Completion (expected)	Country	Value in Local Currency	Value in US$ As at 5.8.2018
1	Bangkok–Nakhon Ratchasima (Ph. 1)	Railway	2017	2021	Thailand	THB 179bn	539mn
2	Vientiane–Boten	Railway	2015	2021	Lao PDR		5.8bn
3	Cirebon–Kroya	Railway	2017	2019	Indonesia		105mn
4	NR 55	Road	2015	NA	Cambodia		133mn
5	East Coast Rail Link	Railway	2017	2024	Malaysia	MYR 55bn	13.47bn
6	Gemas Johor Bharu Double Tracking	Railway	2016	2020	Malaysia	MYR 8.9bn	2.18bn
7	Melaka Gateway	Port	2014	2019	Malaysia	MYR 8bn	1.96bn
8	Muara Terminal	Port, refinery JV			Brunei		3.4bn
9	National Highway No. 5	Road	2013	2016	Cambodia		160mn
10	Phnom Penh–Sihanoukville Expressway	Road	2017	2020	Cambodia		1.9bn
11	Preah Vihear–Kaoh Kong Railway	Railway	2013	2017	Cambodia		9.6bn
12	KA Purukcahu–Bangkuang Railway, Central Kalimantan (PPP)	Railway	2018	2023	Indonesia	IDR 77tr	5.3bn
13	National Road 214	Road		Completed	Cambodia		117mn
14	Sumsel 5 Power Plant	Power		Completed	Indonesia		318mn
15	Jakarta–Bandung	Railway	2016	2019	Indonesia		5.5bn
16	Morowali Industrial Park	Industrial Steel and Power			Indonesia		1.6bn
17	Nam Ou Hydro	Power			Lao PDR		2.8bn
18	Phongxaly–Yunnan	Road			Lao PDR		910mn

Table 1 above shows at least 18 BRI related projects in six ASEAN Member States: Brunei (1), Cambodia (5), Indonesia (5), Lao PDR (3), Malaysia (3), and Thailand (1).

BRI-DRIVEN INFRASTRUCTURE PROJECTS IN ASEAN

Most of the BRI projects in ASEAN Member States initiated since 2013, shown in Table 1, involved railway, roads and power projects.

A few BRI related projects are under review, either to be cancelled or re-negotiated. They include the Jakarta Monorail Project,[5] valued at US$1.5bn and the ECRL Project in Malaysia, which has been subject to a suspension order pending further negotiations between China and Malaysia's new government. Further, the Jakarta-Bandung Railway project is under threat, mainly due to the delay in the release of loan from the China Development Bank.[6]

IMPACT OF BRI-DRIVEN INFRASTRUCTURE PROJECTS IN ASEAN ON TRADE AND INVESTMENT

Most of the BRI projects are developed through joint ventures (JV) between an ASEAN host country entity and a Chinese entity, with financing from China's linked financial organisations.[7]

These JVs carry out their projects under concessions, i.e. the permission of the local government, or direct government procurement. Such concession projects include the Muara Container Terminal and Oil Refinery Project in Brunei, the Melaka Gateway Project in Melaka, Malaysia, and the Jakarta-Bandung Railway and the Morowali Industrial Park in Indonesia. Examples of government procurement projects include the ECRL and Gemas-Johor Bharu railways in Malaysia, and the Lao PDR's Vientiane-Boten Railway.

Upon the completion of the BRI, export of goods from continental ASEAN into China and Europe will be facilitated by the land bridges being built in Laos and Malaysia such as the Vientiane–Boten Railway, ECRL and Gemas–Johor Bharu, Phongxaly–Yunnan projects.

The completion of the "last mile", Vientiane to Kunming, will connect ASEAN to its main global partners, alleviating the needs to rely on the sea route to reach certain parts of China, Central Asia, Russia, and Eastern Europe. The ECRL project, although mainly conceived as part of domestic connectivity, will act as the land bridge between South China Sea Port of Kuantan to the Klang Port in the Straits of Malacca, thus reducing the need for vessels to travel through the busy Straits of Singapore.

IMPACT ON INVESTMENT

China's FDI inflows into ASEAN have been growing from about US$3.5bn in 2010 to about US$11.3bn in 2017.[8] Based on a study by the Heritage Foundation, China's focus has also been shifting from energy into infrastructure, real estate, and other sectors.[9]

Looking at the construction sector, China's FDI inflow into ASEAN has been increasing from US$197.19mn in 2014 to US$719.50mn in 2017 (Figure 1). Further increase in FDI inflows will be seen upon the completion of several projects such as Muara Terminal Project in Brunei (US$ 3.4bn, unknown completion date), the Melaka Gateway Project (RM8bn/US$2bn, due to be completed by 2019), and the Morowali Industrial Park in Indonesia (US$1.6bn, with no indication of the start and completion date).

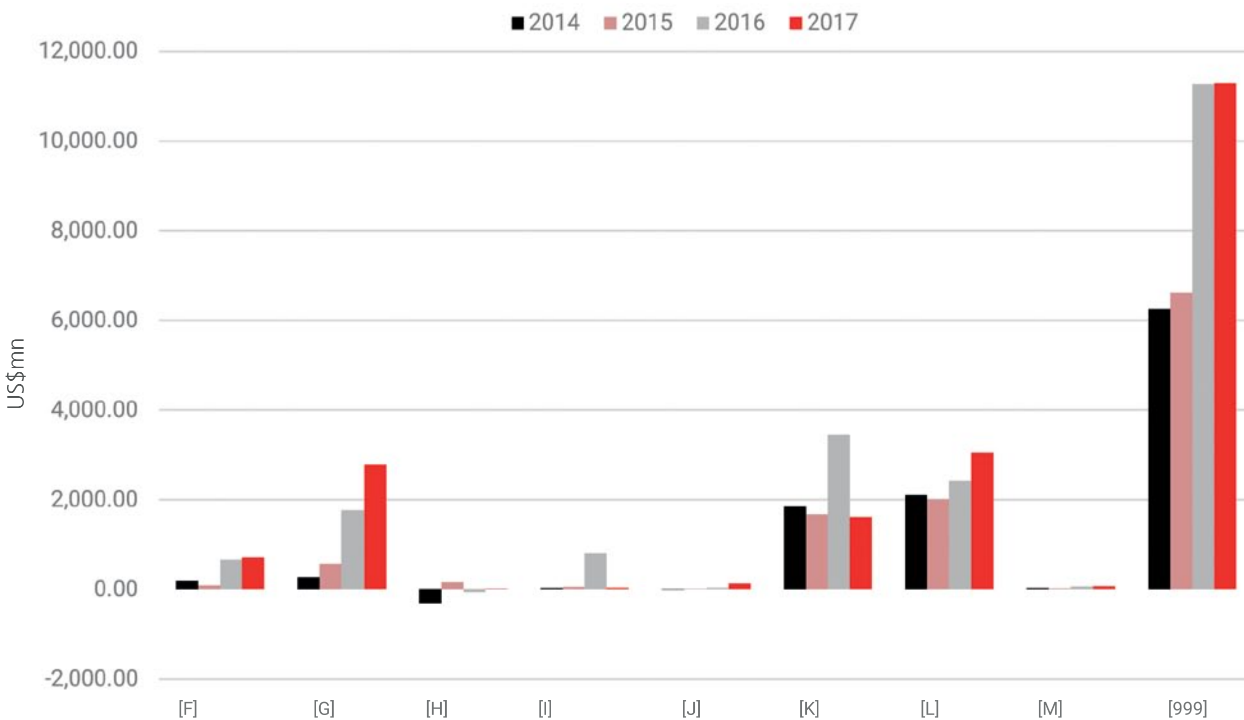
Completion of BRI projects will also mean ASEAN will be able to increase investment in the logistics sector. This could contribute towards spill-over effects in the economy through other investments, such as manufacturing, oil and gas, mining and quarrying and agriculture. The completion of the BRI will plug the investment gaps in infrastructure, which if not addressed, will have a negative impact on the overall economic growth in ASEAN.[10]

IMPACT ON TRADE IN GOODS

BRI projects not only involve investments or flow of capital but also importation of goods from China to ASEAN. These goods may directly and indirectly be used in the BRI projects. Selected goods possibly linked to the BRI projects imported from China to ASEAN are shown in Figure 2 (on page 14).

FIGURE 1: CHINA FDI INFLOW INTO ASEAN 2014–2017

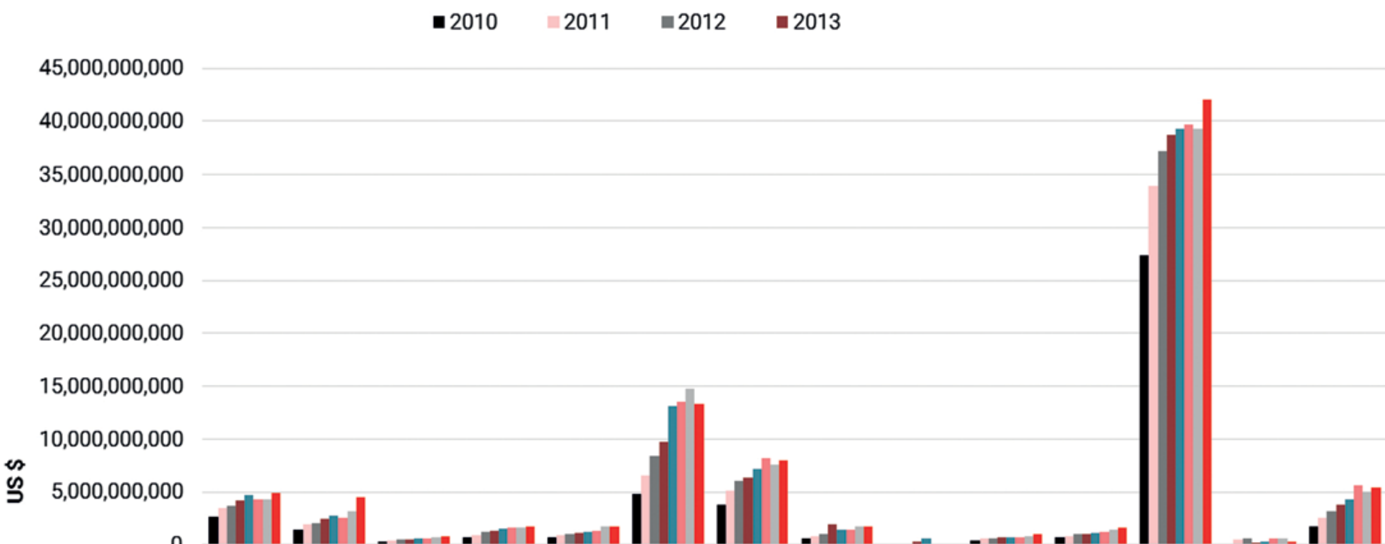
Source: ASEAN Stats



	Construction	Wholesale and retail trade	Transportation and storage	Accommodation and food service	Information and communication	Financial and insurance	Real estate	Prof, science and tech	TOTAL
2014	197.19	269.02	-303.74	23.63	-2.93	1,844.84	2,105.65	23.50	6,254.64
2015	80.59	564.69	168.09	46.80	3.40	1,678.39	2,005.29	12.34	6,620.07
2016	661.82	1,766.85	-57.60	809.02	29.05	3,441.17	2,418.03	53.14	11,275.50
2017	719.50	2,783.75	1.04	28.67	144.90	1,607.30	3,053.43	58.78	11,295.27

Investment Sectors

FIGURE 2: IMPORTS OF GOODS FROM CHINA INTO ASEAN 2010–2017
Source: ASEAN Stats



	[29] Organic chemicals	[38] Chemical products n.e.c.	[68] Stone, plaster, cement, asbestos, mica	[69] Ceramic products	[70] Glass and glassware	[72] Iron and steel	[73] Iron or steel articles	[74] Copper and articles thereof	[75] Nickel and articles thereof	[82] Tools, implements of base metal	[83] Metal; products of base metal	[84] Nuclear reactors, boilers	[86] Railway, tramway locomotives etc.	[87] Vehicles; other than railway
2010	2,641,4	1,442,4	323,204	720,407	712,566	4,853,8	3,783,6	603,356	42,943,	420,208	656,357	27,403,	106,028	1,691,4
2011	3,450,9	1,888,7	387,855	910,592	874,018	6,561,5	5,060,3	807,319	35,759,	569,352	836,542	33,969,	475,765	2,509,9
2012	3,699,0	2,015,1	498,617	1,194,4	982,767	8,401,4	6,064,9	1,045,3	74,501,	621,189	1,048,1	37,221,	600,745	3,143,5
2013	4,166,0	2,467,6	527,120	1,281,2	1,082,6	9,751,5	6,368,9	1,886,1	269,475	675,127	1,039,9	38,741,	198,873	3,775,4
2014	4,739,2	2,735,4	573,151	1,479,1	1,208,3	13,131,	7,137,4	1,377,9	577,373	715,078	1,103,7	39,270,	305,342	4,277,0
2015	4,261,9	2,551,9	646,982	1,592,2	1,329,8	13,549,	8,182,9	1,468,4	125,620	747,068	1,207,0	39,673,	629,942	5,632,5
2016	4,298,8	3,145,4	696,175	1,670,5	1,718,5	14,747,	7,542,0	1,704,1	26,085,	836,455	1,383,5	39,284,	589,549	5,056,2
2017	4,954,5	4,484,9	815,592	1,745,0	1,762,8	13,359,	7,993,8	1,771,5	38,790,	969,988	1,579,4	42,008,	317,017	5,437,5

Since 2010, importation of construction related products from China into ASEAN such as chemical products, ceramic products, glassware, iron and steel and its related articles, copper and articles, tools, metal products, and boilers have been on an increasing trend.

On the other hand, it is possible that importation of some of the products will reduce once BRI projects are fully completed. Rather, there could be an increase in the imports and exports of the intermediate goods, both from ASEAN into China and to the world and from China into ASEAN. This would be able to assist ASEAN to address the trade in goods imbalance between ASEAN and China. Figure 3 (next page) shows ASEAN bilateral trade with China continues to grow in favour of China between 2010 and 2017. However, there is already narrowing of gaps between ASEAN exports to and imports from China in 2017.

TRADE IN SERVICES (ASEAN WITH THE WORLD)

Between 2014 and 2016, ASEAN trade in services with the world has shown an increase in import of services in the sub-sectors related to the BRI projects as shown in Figure 4 (page 17).

ASEAN has been importing construction services, ranging from US$6.2bn in 2014 to US$5.4bn in 2016. China's exports of services into ASEAN increased from US$161bn to US$657bn, whereas, for ASEAN, it rose from US$252bn to US$643bn.[11] China has mainly been exporting engineering and labour services to ASEAN and imports transport, financial and construction services from ASEAN countries.

The BRI may change the balance in favour of China with more export of construction services and related financial services into ASEAN. It can be assumed that ASEAN Member States will import more financial services to help finance the infrastructure projects, based on the projected numbers shown in Table 1 (page 11).

As most of the currently active BRI projects began after 2016, any major increase in the exports of services from China to ASEAN won't be seen until the final 2018 figures at the earliest. Upon completion of the BRI projects, it is expected that some ASEAN Member States may see an increase in the export of transportation and travel services, especially in tourism, through the BRI completed infrastructure projects.

CONCLUSION

China's investments in BRI projects provide an avenue for ASEAN and its Member States to overcome the problem of inadequate infrastructure, which is a major obstacle for both short-term and long-term ASEAN economic growth. BRI projects, coupled with internationally sourced financing including from China, helps to increase the much needed investment in infrastructure projects in ASEAN. BRI projects will also assist ASEAN and its Member States to draw investments into productive sectors such as manufacturing, energy and services.

However, BRI projects could also contribute to the trade imbalance between ASEAN and China. Trade in goods and services between ASEAN and China will continue to be in China's favour. The importations of goods meant for construction of BRI projects will further contribute towards an imbalance in China's favour, at least until the completion of BRI projects. Thereafter ASEAN should work to increase exports to China, to achieve greater balance in the trade of goods and services. ■

FIGURE 3: ASEAN-CHINA TOTAL TRADE IN GOODS, 2010–2017
Source: ASEAN Stats

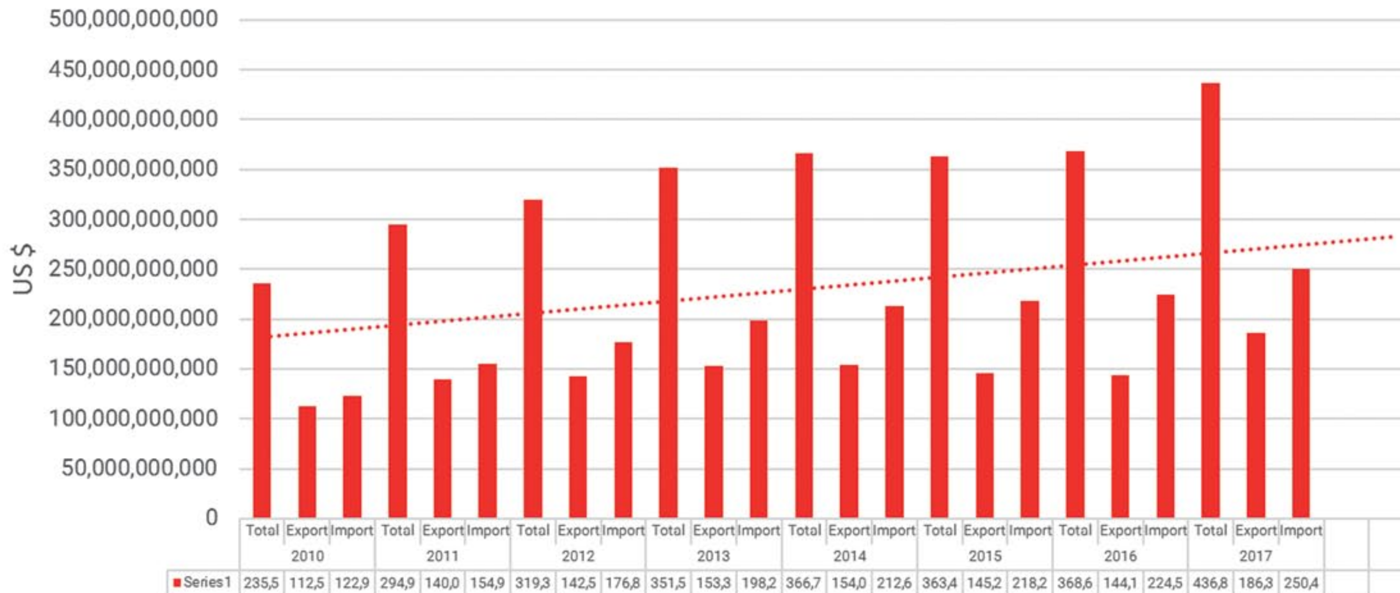
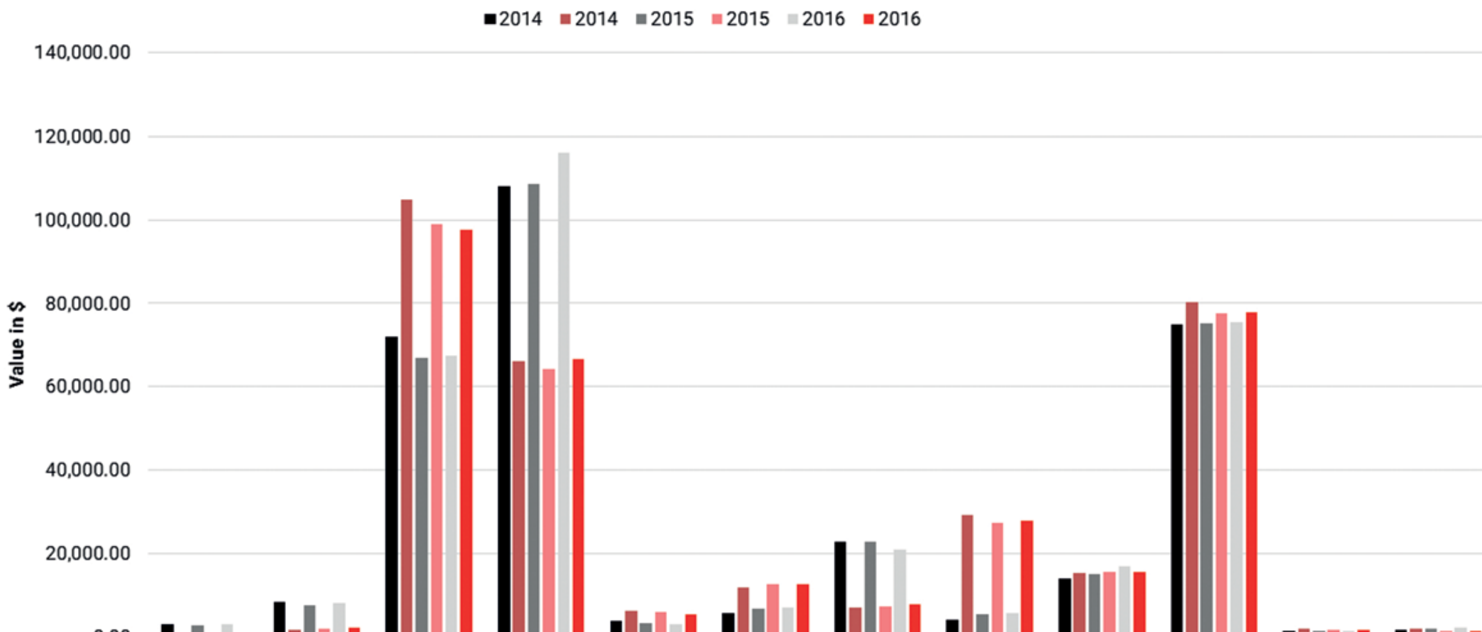


FIGURE 4: ASEAN SELECTED SUB-SECTORS IN TRADE IN SERVICES, 2014–2016
Source: ASEAN Stats



	[A0100] Manufactu-ring services	[B0200] Maintenance and repair	[C0300] Transport	[D0400] Travel	[E0500] Construction	[E0600] Insurance and pension	[E0700] Financial	[E0800] Charges for IP	[E0900] Telecom, comp, info	[E1000] Other business services	[E1100] Personal, cultural, and recreational	[F1200] Government services
2014	2,967.41	8,397.24	72,062.14	108,090.36	3,705.13	5,749.07	22,636.99	4,016.00	13,825.17	74,835.27	1,241.63	1,666.57
2014	185.29	1,692.54	104,801.23	66,105.61	6,247.11	11,729.00	7,006.37	29,242.04	15,310.56	80,229.80	1,815.96	1,782.53
2015	2,655.50	7,615.82	66,859.92	108,565.18	3,151.83	6,765.95	22,867.10	5,443.51	14,970.70	75,078.84	1,235.61	1,781.01
2015	194.58	1,907.10	98,904.87	64,257.77	5,866.62	12,546.50	7,215.38	27,280.78	15,531.83	77,692.11	1,582.39	1,445.16
2016	2,880.05	8,057.84	67,433.26	116,196.33	2,885.29	6,987.87	20,989.84	5,671.96	16,796.48	75,560.94	1,300.25	2,064.81
2016	261.10	2,115.50	97,688.34	66,564.97	5,449.29	12,641.46	7,708.63	27,739.09	15,461.56	77,943.73	1,530.35	1,478.86

Sub-sectors export and import

NOTES

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4 Outlook 2017: ASEAN still beckons, International Enterprise Singapore, 2017.

5 Center for Strategic and International Studies.

6 Siwage Dharma Negara and Leo Suryadinata, Jakarta-Bandung High Speed Rail Project: Little Progress, Many Challenges, ISEAS Perspective, ISSUE: 2018 No. 2 ISSN 2335-667, Singapore, 4 January 2018.

7 This type of activity clearly falls within the definition of investment which involves commitment of capital, the expectation of gain or profit or the assumption of risk. For an example of definition of investment, see the ASEAN Comprehensive Investment Agreement (ACIA), Article 4.

8 ASEAN Secretariat Database.

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Legal issues and implications of the BRI

Hanim Hamzah

> Inevitably, this represents a challenge to the ideal of 'one legal framework' to find single common ground.

China's Belt and Road Initiative (BRI) celebrated its 5th birthday in September. First championed in 2013 by President Xi Jinping, the US$1tr BRI aims to chart new opportunities for international cooperation by building a trade and infrastructure network that connects Asia with Europe and Africa, reaching into more than 78 countries populated by 4.4 billion people and accounting for a third of world GDP.[1]

For the Association of Southeast Asian Nations (ASEAN), the BRI and the ASEAN Master Plan for Connectivity have major shared goals. Both envisage transport connectivity as a way of bringing countries closer together and improving access to trade, investment, and tourism. Given this shared vision, an excellent opportunity exists to find ways forward for mutual, if not equal benefit for both the BRI and ASEAN's regional connectivity.[2]

But in a programme this large, disputes will be inevitable. How will they be settled? This is one of the many legal implications of the BRI programme. Of the 10 ASEAN countries' legal systems, four are based on common laws, three on civil laws, and another three are hybrids of both common and civil law. Simply put, common law works on precedent that can date back centuries whereas civil law works on latest enactments only where, resulting from a juxtaposition of systems of more or less clearly defined fields of application, two or more systems apply cumulatively or interactively. China's legal system is most similar to the hybrids. Inevitably, this represents a challenge to the ideal of 'one legal framework' to find single common ground. Nevertheless common ground can and must be found. There has already been an attempt by China to find a dispute resolution mechanism that is acceptable to all.

There are a large number and wide range of deals and contracts already in place between China and various ASEAN member countries. The example of railway concessions in Indonesia, Malaysia and Laos provides a useful illustration of the BRI's legal issues.

BRI TRANSACTIONS

Based on select BRI railway concessions in Indonesia, Laos and Malaysia, legal issues and implications can best be identified in a comparison of BRI project documents:

	Indonesia	Laos	Malaysia
1. Project	March 2016 concession by the Government of Indonesia (GOI) to PT Kereta Cepat Indonesia China (KCIC)	December 2016 concession by the Government of the Lao People's Democratic Republic (GOL) to Laos-China Railway Company Limited	November 2016 construction of works by the Government of Malaysia (GOM) to China Communications and Construction Company Limited (CCCC) and China Communications Construction Company (M) Sdn Bhd (CCCM)
2. Project particulars	142km rail linking Jakarta to Bandung. Current KCIC shareholding: 60% China Railway International Co Ltd (proposed revision to 90%) 40% Indonesia SOE consortium (proposed revision to 10%): PT Wijaya Karya (38%), PT Kereta Api Indonesia (25%), PT Perkebunan Nusantara VIII (25%) and PT Jasa Marga (12%)	414km rail linking Boten (China-Laos border) to Vientiane. Concessionaire shareholding composition: 70% Government of China (GOC) 30% GOL	620km East-Coast Rail Link (ECRL) connecting Kuala Lumpur to three east coast states in Peninsular Malaysia. CCCC and CCCM as Contractor requirements: for CCCM to be corporation validly existing in Malaysia provide performance bond, usual insurance of works and design guarantee bond perform Works in accordance with Chinese Codes and Standards and Malaysian relevant standards
3. Scheduled completion	31 May 2019 operation, revised to 2020	2021	June 2024[3] (subject to Malaysian government review of project[4])
4. Loan Agreement	Between KCIC and China Development Bank (CDB) for US$4.5bn, 2% flat interest for 40 years, signed on 14 May 2017	Info n/a	Contractor will enter into financing agreements with lenders

	Indonesia	Laos	Malaysia
5. Cost	US$5.988bn increase to US$ 6.071bn due to insurance and Debt Service Reserve Account (DSRA) (75% by CDB and 25% by the KCIC)	US$6bn Each partner to contribute 40% equity portion in cash which means GOL to inject US$715mn over 5-year construction period (of this US$250mn will come from national budget and US$465mn borrowing from Exim Bank at 2.3% interest with 5-year grace period and 35-year maturity)	RM60bn (US$14.7bn)
6. Concession Period	50 years from 31 May 2019	50 years, extendable	60 years
7. Exclusive Concession Rights	Full clearance of required 600 hectare land by GOI	Wide ranging, includes exclusivity for finance, design, construction, ownership, operation, engage in business activities direct or indirectly over the Railway Corridor, employing personnel regardless whether Laos or Expatriate (special exemption from usual quota), installing and operating telecommunications systems with full rights to data, declare dividends	Contractor may hold a build-own-operate-transfer concession for 60 years with lower borrowing costs. This will enable CCCC to recoup its investment earlier[5] Contractor to indemnify GOM as Employer for additional statutory fees or charges with no adjustment to Contract Sum; however Contractor have right of claim against Employer for certain change in laws circumstances and failure to obtain approvals for expatriate workmen
8. Fixing Fares	Rp. 200,000	For passengers–GOL shall approve Concessionaire rates within 15 days of submission or resubmit with caveat of approval within 80%-120% window of rates For freight–Concessionaire at own discretion to determine and fix	70% of the ECRL's capacity will be used for freight services and the remaining 30% capacity will be used for passenger services.[6] Passenger services will cost approximately RM0.20 per kilometre for the 688km ECRL.[7]

	Indonesia	Laos	Malaysia
9. Government support	Presidential Regulation No. 3 of 2016 concerning the Acceleration of 12 Strategic National Projects Land Clearance with Government Regulation No. 13 of 2017 concerning the Amendment of Government Regulation No. 26 of 2008 concerning National Spatial Plan Programs Jakarta Governor Regulation No. 1438 of 2017 concerning Location Determination For The Development of High-speed Rail between Jakarta and Bandung West Java Governor Regulation no. 593/ Kep793-Pemksm/2017 concerning the Determination of Land Acquisition Location for Construction of Train and High-speed Rail between Jakarta- Bandung in West Java area	Guaranteed revenue failure in any year during Operation Period No taxes (including no VAT, income tax, tax on natural resources, etc.) for Project except for certain circumstances No Change in Law circumstances to affect Project Compensation to Concessionaire (extension of Concession Period, grant of additional tax exemptions, direct payment, or any combination of compensations) if Change in Law occurs	Employer amongst others, to be responsible for land acquisition, prepare and procure full environmental impact assessment report, obtain required project approvals Requirements for appointment of local subcontractors The Government of Malaysia supports the BRI and is still remaining friendly with China. However, given that the debt levels of the country amounting to RM1tr, Malaysia decided to review and renegotiate the terms of its major infrastructure projects. Malaysia's Finance Minister Lim Guan Eng was to visit China to renegotiate the cost of the project with CCCC. If renegotiations go well, the ECRL can be resumed within two to three months.[8]

LEGAL ISSUES AND IMPLICATIONS

The following legal issues and implications stand out from comparison of these three projects:

1. ***'Onerous' concession terms:*** While it is common for sponsors to provide legal terms in their favour, these rail concession agreements feature a range of lengthy tax concession periods, long term leases for Chinese companies and imports, plus exemptions from foreign worker quotas that in the longer terms are highly likely to raise issues with regard to the competitiveness of existing domestic industries.

2. ***Conflicting priorities:*** The impact of a national government playing the dual role of commercial actor and regulator becomes problematic if the regulator role must take a back seat to the commercial actor, or vice versa. This can result in a bias towards large infrastructure projects that must be economically and environmentally significant. Allowing for 'onerous' concession terms will debilitate the government's first task which is to govern a country's resources such as by way of protecting the environment and the rights of its citizens. It is important then, in framing concession agreements, to be clear how much a government is relinquishing its traditional responsibility to its population.

3. ***Financing terms:*** Appropriate financing arrangements are a vital element for each BRI project. Most of these can be expected to come from Chinese banks and financial institutions such as the Asian Infrastructure Investment Bank, the Silk Road Fund and the New Development Bank. China is going through a steep learning curve in financing BRI, for example in export credit insurance, cross-border international transactions, project finance models, and security law.[9] It is not a surprise that deployment of funds creates issues because a lot must come together, notably a regulatory system that is able to work across borders, provide transparency, and put in place a balanced approach to address gaps between public and private lending.[10] Part of the complications relate to the credit ratings of BRI countries; some do not have any rating at all. Funders, particularly China policy banks, might then be taking on debt based on under-performing assets, so adding to the issues of non-performing domestic loans already on their balance sheets.[11]

4. ***Debt hangover:*** In addition to deployment issues, the BRI also raises the risk of debt distress–difficulty in maintaining repayment of loans–in some borrower countries. Eight out of the 68 countries that have been identified as potential BRI borrowers are at risk of debt distress based on the pipeline of project lending associated with BRI.[12] Looking at BRI funding arrangements, it appears as if the recipient countries must bear the brunt of most of the financial risk whilst China benefits from both the financing and construction of infrastructure projects. For countries that plan to enter into BRI projects, while the economic prospects are tempting, the loan terms should be considered carefully and an in-depth due diligence must be conducted.[13]

Laos: The 414km Laos railway project linking Vientiane to Boten (on the China-Laos border) has exacerbated Laos' already precarious debt levels, which reached 68% of GDP in 2016. Concerns have been raised by the IMF that Laos, which lacks any railroads, is being led into a debt trap. Because China structures its loans on a case by case basis rather than following the "rules of the road" set out by the IMF or the World Bank, China could end up introducing "new debt vulnerabilities" in developing countries.[14]

Indonesia: Launched in January 2016, the 142km US$6bn Jakarta-Bandung railway is behind schedule. As of March 2018, only 10% of work has been completed. With only half of total land secured, cost escalation has already resulted in the price of the project increasing from US$5.5bn to US$6bn.

5. ***Navigating different legal and regulatory systems:*** Given the difficulties in navigating different regulatory and legal systems such as common law (Singapore and Malaysia), continental law (Central Asia), and Islamic law (Middle East), it is inevitable that disputes and conflicts will arise. A solid legal foundation for the BRI therefore is important as clarity and legal certainty will be crucial components for BRI Projects to promote the flow of international capital.

6. ***Dispute resolution:*** Recognising this, China has taken steps in the right direction. It established the Belt and Road International Commercial Disputes Resolution Mechanism and Institutions at the recent BRI Legal Cooperation Forum which concluded on 3 July 2018. Two new international commercial courts–in Shenzen, Guangdong Province and Xi'an, Shaanxi province[15] will be established to settle and arbitrate cross-border commercial disputes. The establishment of these two international commercial courts will be an addition to the existing global legal framework and paves the way for rules to be harmonised.[16]

   Furthermore, on 1 October 2017 the International Investment Arbitration Rules of the China International Economic and Trade Arbitration Commission (CIETAC Investment Arbitration Rules or Rules) came into force. These will provide new clauses for new BRI contracts and treaties.[17] But it remains to be seen how widely both the Rules, and CIETAC as an investor-state dispute resolution institution, will be accepted.[18]

7. ***Project delays and compensation issues:*** Often, project delays are not attributable to market conditions but to internal in-country politics. Malaysia's ECRL project for instance has recently been suspended on the grounds of "national interest". If the project is terminated, the government will have to pay about RM22bn (US$5.4bn) in compensation and penalty charges.[19]

   While as the contractor CCCC is disappointed with the ECRL suspension order,[20] Beijing is prepared to renegotiate the terms of the ECRL as it is a strategic project that will enable China to bypass Singapore when transporting its exports and imports from Port Klang to Kuantan Port and vice versa.[21] This illustrates the tension between the geopolitical and commercial motivations of the BRI.

CONCLUSION

Big projects obviously require big thinking. The risk allocation between project host governments and China must be negotiated carefully, being mindful that obliging the local goverment to compensate the project for its losses is also a constraint on that government's ability to protect the rights of its citizens and the environment.[22]

An alternative to China's current debt-financing model could be one based on foreign direct investment. A more sustainable business is when shareholders take on venture risks and rewards. The success of the BRI will depend on all parties deploying, organising, and collaborating amongst themselves, locally and globally, rather than everything being centrally coordinated.

Finally, understanding and preparing for the legal challenges is important. Obtaining good advice and remaining astute to the latest legal and regulatory developments to ensure that projects have long-term sustainability is vital.[23] ■

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Southeast Asia's security dilemma–How the West is responding

Nicola Casarini[1]

> As China continues to challenge the existing regional order and the rules-based system in the South China Sea, a firm and united response coming from the West would undoubtedly help find a viable solution between Beijing and the ASEAN countries.

The Belt and Road Initiative (BRI) entails massive investments in infrastructure, including ports, roads and railways connections. Southeast Asia has become the main target so far of BRI's investments. To protect its growing interests–and assets–in the area, China is now building artificial islands and installing military facilities in the South China Sea–a move that is increasing tensions with the ASEAN countries. China's growing assertiveness in the area is also putting the United States and Europe's economic interests at risk.[2] More than one third of Europe's and one fourth of US external trade goes through the Indo-Pacific region, and any escalation of tensions in the area will undoubtedly have a direct impact on the West.

CHINESE ASSERTIVENESS IN THE SOUTH CHINA SEA

China has recently stepped up territorial and maritime claims over large areas of the South China Sea. These claims are not only based on economic and security considerations, but also on national identity and the renewal of China's past glories. President Xi Jinping's reiteration of his vision of a 'Chinese dream', as most recently outlined during the 13th National People's Congress held in Beijing in March 2018, reflects these efforts to rebrand China's image and polish its credentials as a global actor.[3]

Xi's closing speech at the 2018 National People's Congress chimed with an increasingly assertive foreign policy, in particular when he cited China's island-building campaign in the South China Sea as one of the key accomplishments of his Presidency. This implicitly linked his vision of a Chinese dream and the rejuvenation of the country with the idea of restoring the glory of the ancient times when China presided over a Sino-centric order in East Asia.

Chinese policymakers and senior People's Liberation Army (PLA) officials have repeatedly asserted that the islands, shoals, and waters of the South China Sea are now a 'core national interest', alongside Tibet and Taiwan. This is much more than a Chinese version of America's 19th century Monroe Doctrine (against European involvement in Latin America). It goes to the very heart of China's national identity. For instance, in geography classes across the country, Chinese school children study maps of China's territory including the entire South China Sea, where the 'nine-dash line' is clearly highlighted.[4]

The so-called 'nine-dash line' is the border drawn around what China considers to be its sovereign rights in the South China Sea. It includes the islands, banks, and shoals as well as the surrounding waters of the Paracels, Spratlys, Scarborough Shoal, and Macclesfield Bank, and the Pratas Islands all the way down to James Shoal as its southernmost tip–1,800 miles from Mainland China.

Chinese claims emphasise its sovereignty over territorial 'features' (i.e. islands) within the area demarcated by the dashed lines. It follows that overlapping claims, and alternative interpretations, by other countries in the region–in particular Brunei, Malaysia, the Philippines, Taiwan, and Vietnam–are not recognized by Chinese authorities. The hard-line approach taken by the Chinese Communist Party is supported among Chinese public opinion, which has come to view Beijing's construction of artificial islands as perfectly within its rights, since it occurs within Chinese territory. The overwhelming view in China is that these are 'our islands'.[5]

UPHOLDING THE RULES-BASED ORDER IN SOUTHEAST ASIA

There appears to be a glaring division between China and the West when it comes to the application of international law to sovereignty disputes in the South China Sea. In July 2016, after more than three years of deliberation, the Permanent Court of Arbitration in The Hague ruled on the Arbitration between the Philippines and China, making it clear that China's extensive claims to maritime areas within the so-called 'nine-dash line' are incompatible with the United Nations Convention on the Law of the Sea (UNCLOS) and therefore illegitimate.[6] The tribunal also underscored that none of the land features claimed by China qualify as 'islands'–something that would in turn warrant the claiming of an exclusive economic zone under UNCLOS.[7] China strongly condemned the ruling, declaring it "null and void" and questioned the legitimacy of the tribunal itself. This promoted other countries with interests in the South China Sea to reiterate their claims and the US to intensify its 'freedom of navigation' operations (deliberately sailing into waters claimed by China without notification to assert that they remain international waters) to deter Beijing from adopting more confrontational policies in the future.

It is recognised international law and practice that, to prevent deviations from the law, states must persistently object to actions by other states that seek to change those rules.[8] The United States challenges excessive maritime claims under its Freedom of Navigation Programme, the purpose of which is to object to excessive maritime claims that could limit freedom of the seas coming from all states, no matter whether they are friends or foes.[9] Freedom of Navigation Operations (FONOPs) are thus operations by US naval and air forces that reinforce internationally recognised rights and freedoms by challenging excessive maritime claims.

Freedom of Navigation Operations in the South China Sea are therefore used by the U.S to challenge what the international community sees as Chinese excessive maritime claims over large swaths of the Sea. FONOPs have also become part of the US-China tug-of-war over influence in Southeast Asia.

In May 2018, the US rescinded China's invitation to participate in RIMPAC, an international biennial military exercise in the Pacific Ocean. In June the US aircraft carrier USS Ronald Regan anchored in Manila Bay to begin patrolling the South China Sea–the third US aircraft carrier sent to the region since the beginning of the year.

The Trump administration has been rallying allies and partners in the region and around the world to put pressure on China. In this context, the Quadrilateral Security Dialogue (or the 'Quad') between four of the world's leading liberal democracies–the US, India, Japan, and Australia–is gradually becoming a formal alignment. Starting off as a forum for consultation and dialogue on security matters in the Indo-Pacific region, the Quad is currently institutionalising cooperation between the four naval powers with a clear target in mind: China.

Also the Europeans are joining the revamped US effort to increase pressure on China. For instance, in June 2018 a French maritime task group, together with UK helicopters and ships, joined the US and other countries to conduct freedom of navigation operations, sailing naval vessels through international waters in the South China Sea. These operations are also a way to salvage UNCLOS and the principles on which it–and the larger rules-based order–are based. The aim is to convince Beijing to fully agree and support a code of conduct in the area, which should be legally binding, comprehensive, effective and consistent with international law.

At the 31st ASEAN summit in Manila in November 2017, China agreed to begin talks with the regional body on details of a code of conduct (COC) for the South China Sea.[10] At the annual ministerial meeting between China and ASEAN held in Singapore at the beginning of August 2018, the parties agreed on a draft code of conduct that will lay the foundation for talks over the disputed South China Sea.[11] Yet, no timeframe has been given for its completion or implementation and many in the region remain sceptical about Chinese intentions.

The EU has made itself available to facilitate ASEAN-China dialogue on devising a code of conduct for the South China Sea. The EU remains the staunchest supporter of diplomatic initiatives aimed at promoting regional cooperation, multilateralism and trust building–as stated in the ***EU Global Strategy***[12].

There is an emerging Western division of labour when it comes to security issues in the South China Sea, including the upholding of international law. The US is set to continue leading freedom of navigation operations, with support from the Quad countries and some European naval powers, while the EU is intent on using its soft power tools to advance dialogue between China and ASEAN. Such transatlantic alignment begun in 2012, when Chinese territorial and maritime claims over much of the South China Sea began to unsettle the existing regional order.

THE WEST BETWEEN ALIGNMENT AND DIVISION

In July 2012, the EU and the US issued their first–and so far only–joint statement on the Asia-Pacific.[13] The document was the culmination of diplomatic efforts and consultations that had occurred between the transatlantic allies since Autumn 2011, when the final declaration of the US-EU summit mentioned for the first time the Asia Pacific as a region where dialogue and cooperation should be furthered between Washington and Brussels. In preparation for the 2012 joint EU-US statement, the European External Action Service (EEAS) issued an updated and revised version of the Guidelines on the EU's Foreign and Security Policy in East Asia first published in 2007.[14] The revised guidelines published on 15 June 2012 mentioned issues absent in the previous version such as the South China Sea disputes and aligned Europe's position on the Asia Pacific with that of Washington.

The joint EU-US statement was undoubtedly the starting point for closer transatlantic cooperation in Southeast Asia as it included the opportunity for the Western allies to promote a set of principles and values dear to their domestic public opinions. It can also be seen as part of the broader US-led strategy aimed at keeping China in check and displaying the unity of the Western liberal-democratic family to the Chinese Communist Party leadership.

However, since then major differences have emerged within the West. Following the ruling by The Hague Tribunal, the US issued a strong declaration condemning China. The EU–through Federica Mogherini, the Union's High Representative–issued a milder declaration stressing the need for the parties to resolve the dispute in accordance with international law.[15] Beijing had tried to block the statement by putting pressure on some EU member states that had received significant Chinese investments. In the end, the declaration's final version was watered down by Greece and Hungary who did not want to send too strong a message to Beijing at a time of growing economic ties with the Asian giant.[16]

Other EU countries took a different position. At the Shangri-La Dialogue in Singapore in June 2016, France's Defence Minister Jean-Yves Le Drian declared that Paris would encourage the EU to undertake 'regular and visible' patrols in the area.[17] In June 2018, France and the United Kingdom sent naval assets to the South China Sea. On board of one of the French vessels there were also some EU representatives.

CONCLUSION

As China continues to challenge the existing regional order and the rules-based system in the South China Sea, a firm and united response coming from the West would undoubtedly help find a viable solution between Beijing and the ASEAN countries. Yet, as projects related to China's BRI advance, some countries may be tempted to sell principles in exchange for Chinese money. This is a trend that will not bode well for Southeast Asia's security. ■

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US-China tariffs and the BRI talk show

By Pauline Loong

> For ASEAN, the silver lining is the potential for new markets and new investors. For China, where growth has been sputtering for some time, the silver lining is that the trade fight can now take all the blame for what ails the economy.

China will stand by its Belt and Road initiative. No question. It could hardly do otherwise given the high-profile promotion of its ambitious global undertaking–trumpeted as the nation's foreign policy centrepiece and enshrined in the Chinese Communist Party Constitution.

This is Chinese President Xi Jinping's brainchild–his vision of how the world's economic and financial relations could be reshaped in the coming decades. This is the vision that launched the Asia Infrastructure Investment Bank (AIIB), a major diplomatic coup for Beijing that persuaded 57 countries to join the new multi-lateral lender as founding members despite American objections.

But China is in a very different place today from two years ago when the China-led AIIB was making global headlines and from three years ago when the renminbi clinched reserve currency status on joining the IMF's Special Drawing Rights basket.

China today is battening down the hatches for the storm threatening its economy–a storm that will get worse each day that its tariffs confrontation with the United States drags on.

THE SHOW MUST GO ON

Beijing will continue to talk the talk on BRI projects but it is almost certain to drag its feet when walking the walk. The start of new projects (as opposed to opening ceremonies and inking new agreements) will slow and the financing available for projects is likely to be much less attractive.

The problems facing the Chinese economy is the reason why.

The widespread myth is that China has endlessly deep pockets and thus the wherewithal to do whatever it sets its mind to do. The truth is the Chinese economy is much less robust than is popularly believed. Suffice it to say that resources for external largesse cannot be unlimited in a nation with a GDP per capita of US$8,643 against the global average of US$11,730 (current prices).

This is the worst possible time for China to be confronting its biggest export market. The economy is already on a knife-edge. The problems are not cyclical, as some have argued. They are systemic. Among them:

- A rising debt mountain that is almost three times as large as GDP compared with 140% a decade ago.
- Chinese mortgage-fuelled household debt approaching 50% of GDP compared with 30% in 2012.
- Non Performing loans (NPLs) continue to rise despite economic growth expanding at more than 6.5% a year.
- Warnings by the IMF of threats to financial stability from the US$15tr banking sector.

The anecdotal evidence is even more alarming: An increasing number of Chinese firms owe more in interest than they earn after tax, the P2P sector has imploded with hundreds of firms collapsing within days, and continued pressure on capital outflows held back by an administrative firewall. And then there are numbers that just doesn't look right. The 2017 increase in retail sales is not matched by a similar increase in output for consumer products over the period. For both numbers to be true, there would have to be some heroic de-stocking or wild price increases.

IT IS WORSE THAN IT LOOKS

China's leaders are already preparing the nation for seriously tough times ahead. Weeks earlier, a state-run newspaper targeting the judiciary said courts should be prepared for a possible spike in the number of corporate bankruptcy cases as a result of the trade dispute.

Arguments that Chinese retaliation might force the US to back off from its tariff threats ignore the reality that Beijing has few retaliatory options that are cost effective.

The so-called nuclear option–China dumping its holdings of US Treasuries–assume that suicidal revenge is an overriding motivation in Chinese policymaking. Massive dumping of US Treasuries would certainly hurt the US but it is just as likely to decimate the value of China's foreign exchange reserves with bond prices and the greenback doubtless going into freefall from such a massive sale. And this is without even considering the logistics of offloading more than US$1tr in US government paper onto the market in one fell swoop.

And China has a further handicap. Dollar for dollar, US tariffs carry the bigger clout. Chinese goods compete mostly on price in the United States. Not so American goods in China. The Chinese consumer does not pay for an iPhone because it is cheaper than the local product. But when tariffs are increased, the American shopper is likely to think twice about buying a Chinese t-shirt that will cost almost as much as one made in, say, North Carolina.

NEW ERA, NEW OPPORTUNITIES

Yet, as in all conflicts, there are opportunities. An obvious near-term benefit for third-party countries are the supply gaps in both China and the US as tit-for-tat tariffs cut off established sources.

Malaysian exporters, especially palm oil producers, are already eyeing China's soybean market. Last year, China imported 87% of the soybeans it needed of which a third was supplied by American farmers. Beijing is pulling out the stops to boost domestic production. But agriculture is not like manufacturing. Farmers cannot deliver more soya beans at short notice the way that manufacturers of toys or T-shirts can by cranking up overtime. And then there is weather–as Chinese farmers can attest. Unusually early frost hit parts of China in September damaging millions of acres of soybean fields.

But while China can be expected to import more from ASEAN, it will also be looking to sell more to these markets. Chinese steel and aluminium once destined for the US market might now be diverted to Indonesia. Although China is an important trade partner for ASEAN with two-way flows hitting a record US$514.8bn last year, the trade imbalance remains an irritant for these countries. Apart from Singapore, every ASEAN nation has a trade deficit with China.

Furthermore, China will be competing hard with ASEAN exporters for third markets in its bid to replace US demand. This will cause friction especially if the renminbi depreciates and a cheaper currency is seen as unfairly giving Chinese exporters an edge.

Beijing is aware it must tread carefully. Keeping its jobs-generating exports sector buoyant is not just about dollars and cents. The Chinese Communist Party will be celebrating its 100th anniversary in 2021. To have the economy humming along nicely is vital in presenting the nation with a convincing recording of outstanding performance by the ruling Party. It stands to reason that the government will give Chinese exporters every help even at the risk of upsetting some of its trade partners.

WHEN MONEY WALKS

In the medium term, the benefit to ASEAN nations are more likely to come from the relocation of manufacturing capacity from China. Relocation helps producers selling to or sourcing from the US market to remain competitive.

And tariffs are just part of the relocation story. Production costs have been rising for some time in China. Manufacturers have already been relocating capacity across the supply chain to lower-cost countries such as Vietnam and Malaysia.

About a fifth of the companies surveyed by the American Chamber of Commerce in early September are thinking of transferring some or all of their manufacturing out of China, and another third are delaying or outright cancelling new investment on the Mainland. The European Union Chamber of Commerce in China found that one in six of the respondents to a survey of its members are also delaying investment or expansion while one in 14 are considering relocating.

Southeast Asia and India are among the popular destinations for companies fleeing the China-US tariffs confrontation. Some governments, notably Thailand, have lost no time in actively wooing these businesses and encouraging them to move production from China.

IMPORTANT BUT NOT URGENT

Although the BRI is important to the Chinese leadership, it is not an urgent priority. Far more immediate for the nation's wellbeing–and the Party's grip on power–is shoring up growth at home as US tariffs come into effect. And the case for setting aside funds for domestic stimulus projects rather than diverting much needed investment abroad will be far more compelling once job losses become a political issue.

Not that BRI funds will completely dry up. Beijing is pushing the private sector to invest more. And there is Hong Kong. In September 2018, its Financial Secretary noted in his personal blog that the Hong Kong Monetary Authority is considering investing in BRI projects for the first time.

Beijing will continue wooing the 10-nation bloc but will probably re-direct its efforts. Recipient nations such as Malaysia and Indonesia have been taking a more hard-headed approach to China's BRI proposals. And in light of its own changed circumstances, Beijing might decide that efforts focussed more the other ASEAN-5 (Vietnam, Myanmar, Cambodia, Laos and the Philippines) might bring greater dividends.

For ASEAN, the silver lining is the potential for new markets and new investors. For China, where growth has been sputtering for some time, the silver lining is that the trade fight can now take all the blame for what ails the economy. ■

How the BRI will affect the RMB and Chinese fixed income market

Kelvin Tay

> Although the RMB is going through a period of volatility right now as a result of the ongoing trade dispute with the US, the RMB's long term path is likely to be rather different, with its internationalization not only inevitable, but likely to gain further momentum as a result of the BRI.

The return of China has been a key driver of global economic growth over the last decade. In building its roads, dams, rail networks, and cities, China became the world's largest importer of commodities and now accounts for 57% of the annual global demand for iron ore and for 50% of copper. During 2000–2015, China accounted for nearly one-third of the world's economic growth. Over the same period, exports to China increased dramatically from 3% to 9% of world exports and from 9% to 22% of Asian exports.

Today, the welfare of many regions depends in large part on China's continued economic progress. With China projected to become the world's biggest economy by 2030, the country's size and integration into the global economy mean that its performance will likely affect many of the nations around it. At the same time, China's economic reforms and rebalancing are likely to bring about growth dividends for both China and its trading partners, with larger medium-term benefits for Asian countries with a greater exposure to China than the rest of the world.

It is also realistic to assume that as the BRI takes shape, China will also likely increase its foreign direct investments (FDI) in BRI-related countries, making that correlation tighter as China becomes even more connected via transportation links with the rest of the world.

For instance, in 2013 Zhengzhou was one of 7 cities offering rail freight services to Hamburg, Duisberg and Madrid, amongst other cities. According to the Chinese Academy of Social Sciences, the number of rail links has since multiplied to 57, connecting 35 cities to 34 European cities in 12 countries. The next logical progression would be the increased use of the RMB in commercial transactions between these cities.

China's outbound FDI increased sharply in 2015 and 2016, but the amount that is related directly to the BRI was relatively small. In 2016, China's overseas investment was US$170bn, of which US$14.5bn was linked to the BRI. The government now expects an annual US$20–30bn in BRI-related investments in the next few years. Funding so far has been mainly from Chinese state banks, such as policy banks (China Development Bank, Export-Import

Bank) and large state-owned banks. They have financed these projects as lenders to the Chinese companies that are making the investment.

Actual investment from multilateral institutions such as AIIB is still relatively small as these are newly established agencies. Also, they aim to follow international standards and identify good projects, a process that requires time. AIIB allocated less than US$2bn to BRI projects last year. Going forward, these organisations will no doubt try to increase their allocation. At the same time, efforts are also being made to try to bring capital markets into the initiative, as well as third party market funding, including the issue of infrastructure bonds to global investors. Required funding is expected to be so huge that any one country or group of institutions would want to diversify the risks.

BRI'S IMPACT ON THE RMB

The short term trajectory of RMB is likely to be quite different from its long-term potential. With political rhetoric building up between the US and Chinese governments on the back of the simmering trade dispute between the world's two biggest economies, the RMB is likely to be range-bound (moving within a relatively tight range) for the time being, with the possibility of a further weakening closer to 7.00 Yuan to the dollar. In fact, the RMB has weakened by around 4.5% this year versus the Dollar (from 6.50 at the start of 2018). The depreciation has occurred mainly since mid-June, when the exchange rate rose from around 6.40 to as high as 6.82 on the back of a more hawkish US Federal Reserve (which projected a faster rate hike path at its June meeting), poorer than expected Chinese economic data, and rising US-China trade tensions.

However, the RMB's long term path is likely to be rather different, with the internationalization of RMB likely to gain further momentum as a result of the BRI. The use of the RMB in BRI-related transactions is still relatively low, at around 14% of total cross-border trading settlements, compared to the average of 23% for all cross-border trading settlements (according to the People's Bank of China). China has expanded its bilateral local-currency swap agreements to 36 countries by June this year, 24 of which are BRI countries. The total amount of SWAP agreements reached RMB3.3tr.

The BRI is also likely to contribute significantly to the deepening liquidity pool of the RMB. The scale of funding required will mean accessing capital markets not just in the main G4 currencies (US Dollar, Euro, Yen, and British Pound) but also in the RMB. As China becomes an even greater power in international trade and investment, its currency is likely to grow accordingly in stature. BRI-related countries will accept and also make payments in RMB.

Table 1. Share of currency in international payments vs share of global GDP

	Share of international payments currency (as of March 2017)	Ranking	Share of Global GDP (2016 data)	Ranking
USD	41.8%	1	24.7%	1
EUR	31.2%	2	21.8%	2
GBP	7.1%	3	3.5%	5
JPY	3.3%	4	6.6%	4
CAD	2.0%	5	2.0%	10
CNY	1.8%	6	14.9%	3

Source: Swift, CEIC, UBS

BRI aside, we believe RMB's market share of international payments (see table 1) and global currency trades (FX turnover) (see table 2) is likely to climb from 2% today into the mid-single digits in upcoming years. With the current equity and bond connect schemes that permit larger two-way flows in and out various onshore asset channels, we should see a first step up over the next three years, but it's too early to give a percentage at this stage. The potential increase in market share is likely to be nonlinear.

If the BRI progresses very well, that share could rise to around 10% in 10 years. A 10% market share estimate should not be seen as a ceiling. It is less than what we normally see for key G10 currencies relative to their economic size (GDP) (see Table 1 for comparison). Using share of global GDP as a reference, a share as high as 15% is justified for the CNY. Thus, higher market share levels for China are possible over time, especially with a successful implementation of the BRI, but this would require a full open capital account allowing more foreign investment and ownership in China.

Considering how much of the market is concentrated in a few currencies, it will be interesting to see from where most of the market share losses will come from–likely from the Dollar and Euro. That said, a much bigger international currency market in the future (i.e. additional trading volume and not just shifting existing volume) also suggests that smaller currencies could see a reduction in volume. But of course, the CNY has a long journey to travel before it can contend for true global reserve status with the Dollar.

BRI IMPACT ON ASIA

The BRI affects the Asian economies and investors both directly and indirectly.

One of the direct consequences is China's companies and banks issuing more bonds to fund BRI investment, which could limit improvements in the value of the bonds issued by them. Issuers that are deemed crucial to the successful execution of the BRI could become more strategically important to the Chinese government, and become more likely to be supported (see below).

For other participating countries in Asia, the implications are largely indirect. Increased levels of FDIs are likely to improve external positions and growth prospects of these countries, which could lead to stronger sovereign credit profiles (i.e. the ability of the country to borrow).

INCREASED BOND SUPPLY FROM CHINESE ISSUERS

The implications of the BRI on offshore Chinese credit issuers are twofold.

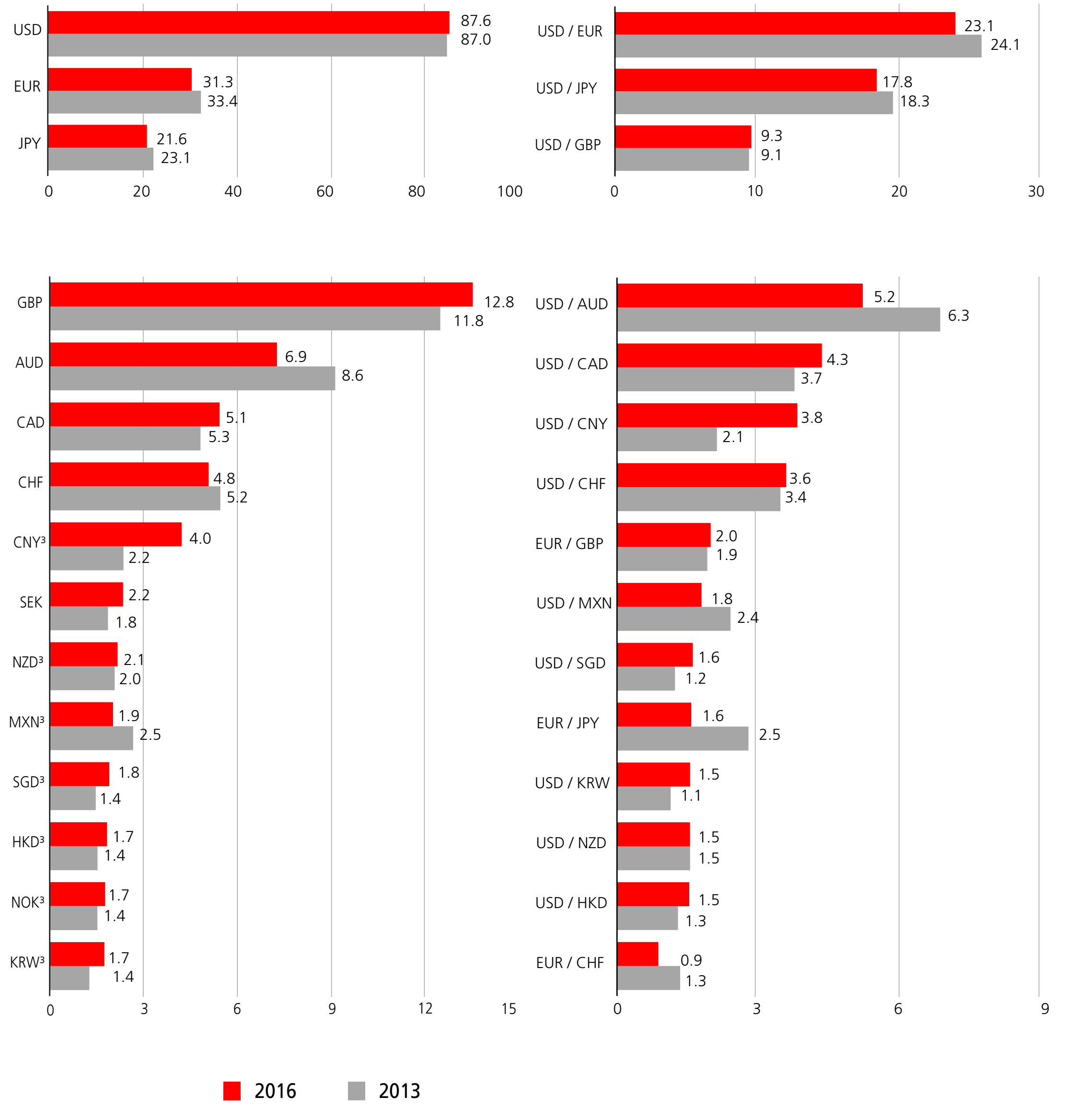
First, the supply of US Dollar bonds is likely to increase. Although funding from the China Development Bank and other Chinese-led regional financial institutions is made available for BRI projects, companies are responsible for raising their own capital to fund the equity portion of the projects. Chinese financial institutions are also more likely to tap the Dollar bond market to finance offshore lending.

As of end of August 2017, Chinese companies had issued a record high US$127bn of Dollar-denominated bonds, accounting for almost two-thirds of the total issuance (US$194bn) in Asia. In comparison, in 2016 just US$175bn US Dollar bonds were issued worldwide. As a result of the BRI, Chinese issuers are likely to continue dominating the offshore Dollar bond market, and we expect total supply to hit record highs in 2017.

Second, the strategic importance of companies involved in BRI projects is likely to increase. This could be more pronounced for SOEs that are currently proactively pursuing BRI initiatives, but which may not enjoy dominant market shares domestically. Second-tier or regionally-focused SOEs involved in steel production and construction which can demonstrate clear overseas expansion plans in line with the government's BRI strategy are more likely to

TABLE 2. Currency distribution of OTC FX turnover

Net–net basis,[1] percentage shares of average daily turnover in April[2]



[1] Adjusted for local and cross-border inter-dealer double counting (i.e. "net-net" basis).

[2] Because two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%.

[3] Turnover for years prior to 2013 may be underestimated owing to incomplete reporting of offshore trading in previous surveys. Methodological changes in the 2013 survey ensured more complete coverage of activity in emerging market and other currencies

Source: BIS, UBS, as of September 2017

be supported. Such support could be in the form of long-term funding from Chinese financial institutions.

The risk is that due to a strong political motivation to show support for the government's initiative, BRI projects could be undertaken even if they are not very viable commercially. As a result, these projects could be more prone to failure in the face of lower-than-expected returns.

OTHER PARTICIPATING COUNTRIES IN ASIA COULD SEE IMPROVED CREDIT PROFILES

Given that most of the projects are likely to be carried out by Chinese companies, we do not see direct implications for existing corporate Dollar bond issuers of other participating countries. However, there are indirect benefits that could lead to improved sovereign credit profiles over the medium term. Big-ticket FDIs can help improve the external positions and growth prospects of participating countries.

In Asia, we believe countries such as Indonesia and Sri Lanka could be beneficiaries. For Indonesia, the BRI presents opportunities to seek much-needed infrastructure development in the country. For smaller frontier economies such as Sri Lanka, the impact could be even greater. For example, the country recently sold its port in Hambantota to China Merchants Group for slightly over US$1bn. This is substantial for a country with a current account deficit of US$1.9bn in 2016 and only US$5.7bn of foreign exchange reserves as of July 2017.

For local currency bond markets, we believe the benefits would largely stem from improved outlooks for the currencies. For instance, we could see more inflows into Indonesia's local bond market if offshore investors consider the Indonesian rupiah to be more stable.

CONCLUSION

China's BRI covers an aggregate population of 4.5bn people or 63% of the world population, with a total economic output of US$27.5trn or 35% of the global GDP (2015). It has created a buzz because it is bringing much needed infrastructure investments to a region that has been starved of any form of modern transportation infrastructure. Through a combination of railway links and maritime sea routes, President Xi aims to blur the boundaries between Asia and Europe, drawing the consumption power of Europe, and the resource rich Central Asian and Southeast Asian countries nearer to China, the "Middle Kingdom".

With a population of 1.4bn highly entrepreneurial people, a stable China will be a prosperous China. And if the country is stable and prosperous, it is inevitable that it will not just be an Asian superpower; its presence will be keenly felt on the global stage too.

As the US retreats and becomes increasingly isolated under President Donald Trump, the Chinese are starting to assume leadership on the global stage on matters such as climate change and free trade, which were formerly the domain of the West. This would have been unthinkable just five years ago. As such, although the RMB is going through a period of volatility right now as a result of the ongoing trade dispute with the US, the RMB's long term path is likely to be rather different, with its internationalization not only inevitable, but likely to gain further momentum as a result of the BRI. ■

BRI as China's 'manifest destiny'? A Thai perspective

Thitinan Pongsudhirak

> If not overly enthusiastic, Thailand's economic policy planners and government leaders remain supportive of BRI, although there are local concerns about a potential debt trap and a raw deal with disadvantageous terms.

No national project of global reach carries as much stake and attracts as much attention as China's BRI. Conceived in 2013, BRI is the colossal brainchild of President Xi Jinping and his government. If realised as planned, BRI would expand China's footprints throughout the Eurasian landmass and through the high seas from China to eastern Africa. The grand project should be understood as a function and campaign of China's quest for a return to the imperial glory it lost over the past couple of centuries.

Indeed, BRI harks back more than a thousand years when trade flourished along what was then called a 'silk road' that straddled the Middle Kingdom and the Western world. By the 14th century, what had become a vibrant overland trade between east and west was complemented by China's maritime exploration under Admiral Zheng He. In conventional textbooks, the oceans and high seas are famously sailed and new lands discovered by Europeans during an 'age of exploration.' But in fact, the Chinese may well have done it all before, only to be subsequently colonised and subjugated, unable to have a say in how world history was to be written.

Such is the context of BRI. When President Xi ascended to power in 2012, he was faced with China's growing greatness that had to be managed and sustained. Maintaining growth and stability at home in the face of eventual saturation and diminishing returns meant having to find markets and projects abroad. In September 2013, President Xi announced the 'Silk Road Economic Belt' (SREB) in Kazakhstan, coupled a month later with his watershed speech in Indonesia for a '21st Century Maritime Silk Road' (MSR). Since then both the overland belt and the maritime road have become front and centre in international affairs, thereby shaping China's geopolitical and geoeconomic engagements.

On the face of it, BRI is a natural offshoot of China's breakneck growth at home. After three decades of phenomenal annual growth, in double digits for many years, overcapacity issues beset the Chinese economy, as growth slowed to a 6% range. China's huge internal market became insufficient. Its huge state-owned enterprise sector was particularly vulnerable to economic slowdown. Growth symptoms, such as urbanisation, consumerism and urban-rural inequality, became conspicuous and alarming. The only way forward was to make the world China's ultimate market. As its trade and investment with the outside world rapidly expanded, China has become a major locomotive for global economic growth. For Southeast Asia, for instance, China now stands as the largest trade and investment partner, displacing the United States, Japan, and the European Union, which were dominant just 25 years ago.

But BRI is designed for much more than addressing overcapacity at home. China wants to increase its economic and financial power by promoting its currency unit, the renminbi (RMB), as a global reserve currency. That the RMB is now part of the International Monetary Fund's Special Drawing Rights basket of leading currencies testifies to China's financial ambition. China's pursuit of a global currency role is to overcome what the late Susan Strange, who taught at the London School of Economics, called the United States' 'structural power' rooted in the mighty dollar as currency of first and last resort.

Yet in recent years, the RMB has faced uphill tasks in trying to become a global currency. According to People's Bank of China's data, the RMB was the 5th most used payment currency in the world in 2016 and 8th in global foreign exchange transactions. Only 29% of China's trade was settled in its own currency, and only 10% of China's outward direct investment was transacted in RMB. The RMB's cross-border role peaked in 2015 but has been on the decline since, owing to fears of depreciation, let alone devaluation by China's authoritarian capitalist government. To make the RMB a global currency requires China's ability to promote global capital mobilisation in its own currency to foreign entities.

This is where the BRI comes in. Already, BRI is backed by considerable financial muscle. Loans worth some US$30bn have been agreed by China Development Bank, another US$80bn from its Export-Import Bank, with commitments through China's Asian Infrastructure Investment Bank for another US$30bn and New Development Bank for US$20bn. China's Silk Road Fund provides another US$40bn in potential financing. All told, some US$900bn has been estimated for 60-odd countries involved with BRI in the coming years, covering more than 4bn people along the routes. Depending on timelines and varying estimates, the total amount in BRI-related infrastructure investments could come out anywhere between US$4tr and US$8tr.

Moreover, as a land power, China needs to secure its energy lifelines away from the seas, where US naval prowess remains immense and potentially threatening to Chinese interests. More than 80% of China's crude oil and 30% of natural gas imports from the Middle East are shipped through the Straits of Malacca. If push comes to shove and the Straits are closed off, China would be crippled. The US is the only country with the maritime might through its naval forces that can dominate both the Indian and Pacific oceans at the same time, certainly more than any other major power could muster.

Unsurprisingly, China's BRI projects, especially those with Pakistan, are intended as energy hedges against China's maritime vulnerabilities. The China-Pakistan Economic Corridor has been estimated to be worth US$40bn. Working so closely with and investing so much in Pakistan has incurred India's ire and local resentment but China sees the risks as unavoidable.

To be sure, China's BRI has been met with multi-layered pushback. At the geostrategic level, the "Free and Open Indo-Pacific" (FOIP), supported by the US, Japan, Australia and India to a lesser extent, is geared to check China's expansionist projects. So far, the FOIP still lacks concrete vision, programmes, and resources, but it is now codified as the US' main strategy for its engagement with Asia. With the US' full backing, the FOIP is likely to gain more traction.

Some of the recipient countries of Chinese funding from Sri Lanka and Pakistan to Malaysia and Montenegro have become increasingly concerned over China's undue leverage and potential "debt traps" for dependent developing countries. Suspicions among BRI-involved countries over Chinese objectives and methods are likely to intensify in the coming years.

Nevertheless, China now may see within its right and entitlement–its own version of 'manifest destiny' to regain its lost imperial glory by reasserting and reconstructing its ancient silk roads. This is analogous to the US' rationalisation for continental expansion in the early 19th century. Neither denying China's historical role nor appeasing its expansionist claims and aims is the way to go. Engaging and enticing China to make its BRI and financing vehicles, such as the AIIB, consistent and compatible with the hitherto rules-based international order is the only effective and workable way to allow and enable China to regain some but perhaps not all of its past greatness and glory.

When it comes to mainland Southeast Asia, BRI pathways do not apply directly. While Vietnam is located near the MSR, Cambodia, Laos, Myanmar, and Thailand–the CLMT group of countries in mainland Southeast Asia–are to be connected to the SREB through two of the clutch of corridor linkages, such as the China-Pakistan Economic Corridor. One corridor is to connect Yunnan in southern China to a port in Kyaukpyu in Myanmar's southwest region in Rakhine state by a railway. Owing to Myanmar's terrain and internal conflicts, the Yunnan-Kyaukpyu corridor has made little headway.

The other is to build a rail link from Yunnan to Vientiane in Laos, before crossing the Mekong River and connecting with Nong Khai province in Thailand's northeast region. From Nong Khai, the railway would continue all the way through Nakorn Ratchasima province to Bangkok and the Gulf of Thailand. Land-locked Laos has taken a US$5.9bn loan from China's Export-Import Bank for the railway construction over five years until 2021, when construction is planned for completion. This rail project in Laos is making progress and on course so far but its overall cost is more than half of the country's GDP, with Laos holding only 30% of the company that was set up to carry out the concession.

On the other side, Thailand's portion of the rail connection from Yunnan through Vientiane has faced delays because of domestic politics. The military government of Prime Minister Prayut Chan-o-cha initially went head over heels for Chinese support after seizing power in a military coup in May 2014. But after China's tough conditions for the rail project, including rights over land use and imports of Chinese workers as well as relatively high interest rate, the Prayut government dithered. Partly as a result, Prayut was one of three ASEAN leaders not invited to the major BRI forum in Beijing in May 2017.

If not overly enthusiastic, Thailand's economic policy planners and government leaders remain supportive of BRI, although there are local concerns about a potential debt trap and a raw deal with disadvantageous terms. The military government has sought, like its neighbours such as Malaysia, to balance Japan's similar interest in regional infrastructure development vis-à-vis China's. The Thai government, in principle, has agreed to allow Japan to build an east-west railway across the central region to connect horizontally with Laos and Vietnam, but this plan remains under a feasibility study phase.

With an eye towards returning to power after an election in 2019, the Thai military government has tried to blend its cornerstone 'Thailand 4.0' development strategy, with its Eastern Economic Corridor (EEC), with BRI. With potential investments upwards to US$50bn, The EEC is a special economic zone focusing on new industries, such as next-generation cars, smart electronics, affluent medical and wellness tourism, digital and medical services, robotics, aviation, biofuels, bio-chemicals, among other 'S-curve' niches.

Most conspicuous is the renewed interest in Thailand's ancient but alluring elephant project–a canal across the Kra Isthmus in southern Thailand, connecting the Andaman Sea and the Gulf of Thailand against the backdrop of a second passage between the Indian and Pacific oceans. If built, the multibillion dollar canal would reduce shipping distance through the Malacca Straits by 1,200 kilometres. It would provide a new and strategic channel of trade and transport to China and Japan, with far-reaching geopolitical implications. Thailand's role would rise but it may undercut Singapore's status as the region's maritime hub. As a consequence, ASEAN unity and centrality may be further undermined.

The Kra Canal through southern Thailand would also pose domestic conflicts. The Thai mindset is glued to a unitary state and geographical setup after past decades of territorial concessions to Britain and France. Cutting through Thailand's southern peninsula and putting a canal in its place would also bear ramifications for the virulent Malay-Muslim insurgency in southernmost border provinces. Despite periodic interest in public discourse, the domestic wherewithal among the populace and officials has been seen as sufficient to make the Kra Canal happen. But now Thailand has a new reign under King Maha Vajiralongkorn, after seven decades of a glorious era under King Bhumibol Adulyadej, and perhaps a new kind of politics will be in the offing. The Kra Canal has long been a nice dream but its realisation was just always too far away. It is now less inconceivable than in the past, possibly much like Suvarnabhumi Airport, Thailand's main aviation gateway in Bangkok. For decades, Suvarnabhumi Airport was known merely as a swamp full of cobras.Eventually it did get built after years of dithering, incompetent governments, corruption, and other impediments. Market demand made it happen. If BRI can offer similar market demands, the Kra Canal could become Thailand's most valuable and consequential brand to China's grand enterprise. ■

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Conclusion–
If Truly Collaborative The BRI Can Work For All

Tan Sri Munir Majid

> There is a margin for negotiation and meaningful sovereign existence.

ASEAN member states do not have an adversarial attitude towards the BRI based on China's global intentions and geopolitical calculation. Indeed these states gladly welcome the BRI for the scale of infrastructure development and connectivity it promises to bring to their economies. They are not swayed by arguments about China's grand design to dominate the world through the BRI.

Nevertheless there has been opposition to BRI projects as a result of the fear of being buried under Chinese debt, of losing sovereign rights in dealing with Chinese companies, of unfair financial and contract terms, and of limited participation by locals in project implementation.

Malaysia is the most recent–and perhaps the strongest–example of assertion of sovereign right in seeking a review, even the scrapping of BRI-related agreements previously rushed into. The coming to power of a new government following the May 9, 2018 general election, which had accused the previous government during the campaign of establishing a client-master relationship with China, lent a dimension of challenge to the Chinese expression of BRI as an unquestioned good.

The revelations of project terms, such as payments well ahead of and totally unrelated to the progress of work, will be a huge embarrassment to China. China already had to endure the suggestion of money-laundering in the arrangement to relieve financial pressure on a scandal-plagued Malaysian government company with which its previous Prime Minister was closely associated.

These revelations of "unequal treaties", as the new and returning Malaysian Prime Minister termed them in historical reminder, must have been discomforting to China. An official visit in August by the new Malaysian leader Mahathir Mohamad–an old friend to China during his previous 22 years as Prime Minister–papered over the cracks and put a gloss on relations, but the immediate BRI project issues remain to be resolved and the longer term impact on China-Malaysia relations is uncertain.

How the project issues are reviewed would indicate if China is open to renegotiation of terms in BRI projects when they are found to be palpably one-sided. A matter of particular interest is whether China will act to ensure its agencies do not impose damaging and questionable terms on countries that are to allegedly benefit from the BRI. This would also indicate if President Xi Jinping is sincere about rooting out corruption.

More broadly, what will be closely followed is how bilateral relations are affected if BRI project terms are disputed, even if legitimately. The Malaysian case is not the first. There have been issues raised on BRI projects in the ASEAN region in Myanmar, Thailand, Laos and Indonesia. But the Malaysian case involves the most extensive exposure of deals which lends credence to many suspicions about debilitating BRI project terms, if not quite to allegations of China's global grand design.

Indeed, there will be close observation of China's conduct in relations with smaller countries–of whether or not its oft-repeated assertion of mutual respect is real, or gets subsumed as it grows in influence and power.

In terms of trade in the past decade and of investment flows in the last few years China has already become the dominant power in the region. Although with respect to regional investment the EU, the US and Japan are still predominant, the increase in China's investment in recent years, and that will come with BRI, will propel the country into becoming one of the region's leading investors to accompany its already leading position in trade.

In respect of the South China Sea ASEAN has already succumbed to de facto recognition of China's extensive territorial claims and to a timetable in settlement process (with ASEAN claimant states) which follows the long Chinese historical calendar–by which time of course there might not be much left to bargain with.

So China's dominance in Southeast Asia comes close to being a *fait accompli*. What remains is for the US, as the power being displaced, to show it really has long term commitment to the region. ASEAN also welcomes this, but is not too confident about it following serial American retreats. Decisions such as TPP withdrawal, closing the door on open trade, are not compensated by latter, and paltry, US$ 113bn for regional infrastructure, against China's Trillions BRI-wide.

China's economic rise, and initiatives such as BRI, reflect the new regional geopolitical reality. What remains is for individual ASEAN states to make sure that with the BRI they do not fall into a client-master relationship with China. They need to avoid total subservience. Can they still do it?

While ASEAN states can be agnostic when it comes to deep suspicion of the BRI (in Western narrative as China's grand design to achieve strategic geopolitical ends to dominate the world), they cannot be blind to its breath-taking sweep and significance. The scores of countries, comprising over 4.4bn people and constituting more than one third of global GDP, in the web of roads, sea routes and pipelines that are on the extensive infrastructural map of BRI, will become associated with China's further rise. This is a huge slice of the world.

Even if, in the geopolitical contest between China and the US, there is little they can do to determine its outcome, most likely, a confirmation of China's regional preponderance, they are well advised not to become ensnared in a dependent and unequal relationship under the BRI which would damage their national interest. Particular examples outside the region in Montenegro, Zambia, Sri Lanka and Pakistan can be cited as clear instances of this risk. We have noted the Malaysian case. It can be argued therefore that each BRI project should be treated with professional objectivity and transparency rather with blind enthusiasm which can do national self-harm.

The countries of Southeast Asia and ASEAN must distinguish between perhaps a geopolitical inevitability and their own national fate. There is a margin for negotiation and meaningful sovereign existence. ASEAN itself provides a platform on which to discuss such issues. ASEAN failed in forging a common position in **opposing** Beijing's South China Sea claims, but can it take an agreed position in **accepting** the BRI?

Singapore signed a MOU with China in April 2018 for collaboration between companies from the two countries in BRI projects. Singapore of course has good financial and legal infrastructure which could help ensure sustainable agreements. Singapore is also a country often cited as one of the least corrupt in the world. It might be useful for ASEAN member states to use the MOU as a basis, even a template, for their own BRI project agreements. There can be regional comfort in company in BRI and in not going totally solo. After all there is the Masterplan on ASEAN Connectivity (MPAC) that needs to be worked into and alongside the BRI.

ASEAN can therefore participate in BRI not only by receiving but also by giving, in offering regional perspectives, advisory services and legal frameworks. In this way some of the BRI project problems that have surfaced can be avoided–and the BRI can be seen as a not totally China dominated enterprise, something Beijing has so often said it is not meant to be. ■

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Editors:
Tan Sri Dr. Munir Majid
Dr Yu Jie

Copy Editors:
Joseph Barnsley
Daniel Thomson

LSE IDEAS
Houghton Street
9th floor, Towers 1 & 3
Clement's Inn
London, WC2A 2AZ

ideas@lse.ac.uk
www.lse.ac.uk/ideas

Cover image:
shutterstock.com

@lseideas

facebook/lseideas

CIMB ASEAN Research Institute
13th Floor, Menara CIMB,
Jalan Stesen Sentral 2
Kuala Lumpur Sentral,
50470 Kuala Lumpur
www.cariasean.org