

Unraveling China's Investments in Malaysia

By **Tham Siew Yeap**

China was not an important investor in Malaysia prior to 2012. However, after the announcement of “One Belt, One Road” (or OBOR) in late 2013 — subsequently renamed the Belt and Road Initiative (BRI) — Malaysia has increasingly attracted more investments from China. According to the Economist Intelligence Unit (EIU)’s China Going Global Investment Index, which ranks 59 major economies in terms of their attractiveness to Chinese firms, Malaysia’s ranking jumped up from 20th in 2015 to fourth in 2017. While the speed at which China’s investment has increased has attracted public attention and concern, there are other dimensions to China’s investment that may not be so obvious to the public eye. These include the sectoral and geographical spread of these projects, scale of investment, funding mechanisms, as well as the types of stakeholders that are involved in these projects.

Key Features of China’s Investment in Malaysia

Although China’s investment is associated with the BRI, there is no mutually agreed definition on what constitutes a BRI investment. This article considers all of China’s investments in Malaysia as BRI-related while making distinctions in pre- and post-2012 Chinese investments.

Before 2012, China’s investment in Malaysia was mainly focused in resources and construction. Manufacturing was insignificant since the production infrastructure in the two countries was more competitive rather than complementary. However, changes in the domestic economic conditions in China and Malaysia have changed the viability of Malaysia as an investment destination for manufacturing projects. Approved investment in manufacturing grew steadily and peaked in 2016, when China became the largest investor in this sector for the first time.

Lower costs of some raw materials and overall production costs relative to China, as well as good infrastructure support has even attracted investments in what are deemed as sunset sectors in Malaysia, such as textiles. Malaysia has continued the use of traditional instruments such as fiscal incentives and land to attract foreign direct investment (FDI) for these investments from China. Unlike traditional market-seeking motivations, some of the investments in the manufacturing sector seek to use Malaysia as an export platform to third countries, be it back to China or to the USA as in the case of investments in the solar sector. Malaysia is also used as a gateway to the ASEAN market.

Within services, notable investments are found in selected service sub-sectors such as telecommunications, banking, and real estate. Infrastructure development includes ports and railways. Kuantan port on the east coast of Peninsular Malaysia is being expanded while on the west coast, a string of ports is reportedly being planned with the help of China’s investors. The East Coast Rail Line (ECRL), which is being constructed, plans to connect Kuantan port to Port Klang, the largest port on the west coast, for the transportation of freight and people. These Chinese infrastructure related projects are deemed to be investments in Malaysia’s strategic assets.

Tham Siew Yeap, Senior Fellow at ISEAS, Singapore, explains that “There are dimensions to China’s investment that may not be so obvious to the public eye.”

China's investments are not confined to a particular region alone; instead they are geographically spread out from north to south and from west to east in Peninsular Malaysia. Investments in East Malaysia are resource-seeking — taking advantage of the oil and gas reserves there, although there is also new investment in manufacturing.

Stakeholders in Malaysia include federal and state level state-owned enterprises (SOEs), private sector as well as allegedly some royal households. For example, the Kuantan Port Consortium consists of IJM Land Sdn. Bhd., a publicly listed private company; and Sime Darby Property Bhd., which is a government linked company and the Pahang state government.

The scale of these investments ranges from millions to billions of dollars. China's third largest homebuilder, Country Garden, is reportedly investing \$100 million to build Forest City in southern Malaysia, tapping its proximity to Singapore. Private car manufacturer Geely's \$108 million equity investment in Proton seeks to transform the ailing Malaysian national car company with new technology acquired from its acquisition of Volvo as well as new management based on market-driven principles such as cost efficiency. Alliance steel's investment of \$1.07 billion in the Malaysia-China Kuantan Industrial Park (MCKIP), sister park to the Qinzhou Industrial Park (QIP) in China, is manufacturing steel for domestic and export markets. Guangxi Beibu, which operates four ports in Southern China, bought an equity stake in Kuantan Port Consortium for approximately \$83.6 million. The East Coast Rail Link (ECRL) is projected to cost around \$14 billion currently, and is expected to be completed by 2024 and to break-even by 2032.

Some of these investment projects differ from the traditional FDI projects in that they are not funded by equity and investment fund shares, reinvestment of earnings, and inter-company debt instruments. Instead, they are financed by non-inter-company loans from China, such as loans from Exim Bank China, and which are guaranteed by the Malaysian government. FDI data therefore understate the extent of China's investment in the country. These non-FDI projects are also at the same time mega projects, which hold considerable risks due to uncertainties over cost escalations which usually spread over a number of years. There is also substantial uncertainty over the demand and the accuracy of demand projections for the utilization of the planned new infrastructure. For example, the viability of a new port is very much dependent on complementary development in the hinterland. Developing a port without concurrent development of a vibrant hinterland can lead to a white elephant. Supply does not automatically create its own demand.

Managing the Challenges in China's Investment

Public concern in Malaysia is focussed on the riskier infrastructure projects and may not realize that China's FDI also includes traditional sectors such as manufacturing and services, which have the potential to contribute towards economic growth. Some of these projects have the potential to complement each other as with the MCKIP and Kuantan port. However, China's investments also have spill-over effects in terms of inflows of other complementary factors such as workers and suppliers from China, leading to concerns over their impact on the domestic economy and society. It remains unclear whether there is sufficient demand for all the planned infrastructure projects, especially the numerous planned ports, given that China is also developing other ports in Southeast Asia. Finally, managing the challenges in China's investment is not just about managing the financial aspects of the different projects, nor their economic impact, but the implication of the sum total of all these investments on the extent of influence that China has or will have over Malaysia, especially in the geo-political arena.

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