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Belt and Road Initiative:
China's Lending Hands come with Claws

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With the economic crisis unfolding in Sri Lanka, there is a renewed interest in better understanding and analyzing the Belt and Road Initiative to prevent nations from both falling under China's orbit and as a consequence to its "debt-traps". This issue brief broadens the scope of analysis on the BRI by examining projects in South East Asia that may have greater geo-economic and geo-strategic significance than debt traps or deep sea ports or even power rivalry. While China has taken advantage of the infrastructure deficit in South East Asia as it has in other parts of the world, the old adage, 'the devil is in the details' is an appropriate characterization of the BRI in the region. This issue brief details the cost of roads laid per mile to the significance of special economic zones (SEZ) in the Mekong region in shaping the regional trade architecture.

Introduction

Most scholars and analysts studying the Belt and Road Initiative (BRI) have focused and limited their analytical efforts to South Asia. While some have delved into East African projects and South East Asian projects, the geo-economic and geo-political implications of these projects have not been comprehensively studied. Macroeconomists and international relations scholars restricted their scope of analysis to South Asia and have identified debt sustainability as the major challenge associated with BRI infrastructure projects. The economic crisis that has unfolded over the first half of 2022 in Sri Lanka has led to a renewed interest in understanding the role of China's BRI in the economic well-being of its participants. While several studies have focused on Sri Lanka's Hambantota port and explored soft power influences, the case of Sri Lanka has been used and overused to portray the Initiative in a certain manner. This characterization does not serve scholarly purpose and limits the analytical scope of the research.

This paper challenges these assumptions and explores the multi-dimensional challenges associated with the trillion-dollar initiative in South East Asia. In particular, this paper examines the scope of select projects in South East Asia and the larger grand strategy ambitions of the Chinese state that it may serve.

China's weaponization of interdependence[1] is a high possibility given its increasing role in South East Asia's economic story. Through the BRI, the region has fallen into China's sphere of economic influence, blurring the line between economic and security relations. With China's increasing control of the region's industrial policy through its economic initiatives, the political apparatus of the nation-states of ASEAN will have very little to offer in terms of strategic autonomy to its security apparatus. This is strikingly apparent in states such as Laos, Thailand, Cambodia, and Myanmar and less so in states such as Vietnam and Indonesia.

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Furthermore, the overbearing nature of China's state owned enterprises on the region's economies have the potential to destroy or limit indigenous industries. This paper addresses two major aspects of the BRI in South East Asia that broadens the scope of analysis. One, the role of special economic zones (SEZs) in assisting China skirt guidelines of rules of origin. States such as India have been hesitant to be part of trade deals such as the Regional Comprehensive Economic Partnership (RCEP) over a lack of strong mandates on "rules of origin" guidelines. Two, the role of "roads to nowhere" in BRI is an understudied phenomenon. While there have been insinuations and suggestions that roads and railway lines that lead to deserted regions of the world, such as ones constructed in mainland China are simply the use of China's glut of raw materials required to build infrastructure and to employ its large labor force, this paper contends that the destination of the roads, railway lines and bridges is the realization of the Chinese state's grand geo-economic and geo-strategic ambitions. In this paper, select projects have been analyzed as case studies that affirm such an ambition.

The paper is broadly divided into three sections. The first section focuses on South East Asia's foreign policy, its macroeconomic environment and its economic needs. The second section dives deeper into China's role in the region, in particular the expansion of special economic zones and the role of expensive infrastructure projects in serving the Chinese state's political ambitions. And the final section offers policy recommendations for nation-states of the region and to nations seeking to address China's acts of economic coercion.

South East Asia: Caught between Two Worlds

Historically, South East Asia has been hostage to the foreign policy of the West and the East. During the world wars, it was either colonized by the British or the Japanese and post war South East Asia faced the brunt of the Cold War. Fast forward fifty years and the region has successfully mastered the art of hedging between world powers. It is one of the largest recipients of aid from both the Asian Development Bank[2] and the Asian Infrastructure Investment Bank (AIIB) and continues to be the most sought after destination for foreign direct investment from China and the Western world. Its frontier and emerging market status coupled with the region's increasing interest in industrializing its agrarian economy, evident through its liberalized foreign direct investment policy, has attracted investments from large multinational corporations of the Western world and state-run enterprises of China alike. To enhance its industrial attractiveness to global investors, the region welcomes infrastructure projects regardless of their economic and financial feasibility. While development banks such as Japan's ADB have instituted transparency in their lending mechanism and have stipulated favorable terms for sovereign states to repay loans, the same cannot be said of China's state development banks such as the China Development Bank (CDB) and the Export-Import Bank of China.[3] This is evident in the equity and debt[4]ratio of several projects in the region.

The region faces an acute shortage of basic infrastructure and the high levels of poverty exacerbate the dire situation. According to estimates of the ADB, the region requires an annual investment of $210 billion to meet the growing needs of its populace. It is this burgeoning demand that has invited multiple development banks and export-import banks into the fray. On multiple instances, this demand has made countries in the region choose lenders that served short-term interests over long-term interests. While it is certainly a challenge to infer the intentions behind this credit availed on the part of the country's leaders, the systemic deficit in infrastructure remains with few alternatives. Thus, BRI's infrastructure initiatives in the region have been easier to execute and found wide acceptance. The resistance to projects has been muted in many countries in the Mekong region (excluding Myanmar). Interestingly, the issues in Myanmar had an environmental angle and displacement of people, inviting direct protests from the displaced communities. However, in neighboring countries, the challenges are more concealed, both due to lack of transparency and the nature of projects.

The BRI has two corridors in the region – Bangladesh-China-Myanmar and the other that traverses Thailand, Vietnam, Laos, Cambodia and Malaysia, also known as the China-Indochina Peninsula Economic Corridor (CICPEC). These corridors are designed after careful consideration of the complementary nature of business ecosystems in China's southern provinces that border the peninsula. The ecosystem in Yunnan, Hainan and Guangxi are connected to the hubs of production and export in the Mekong delta, thereby giving an alternative route to China's exports.

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China's Lending Hands

China steps in to finance projects and assist in building industries and infrastructure vital to sovereign states in the region and to its own geo-economic ambitions. This is evident in its strategic placement of special economic zones bordering its southern provinces. Across multiple geographies, China has successfully capitalized on emerging markets that have sought out investments, regardless of their place in the value chain. Countries such as Vietnam, Thailand, and Laos have absorbed China's manufacturing output by adding insignificant value addition to an otherwise completed product, i.e., over 80 percent of the product manufactured in mainland China and the rest in South East Asia, conveniently earning a tag of made in Vietnam or Thailand or Laos. By skirting country of origin guidelines, China is able to successfully avoid costly tariffs while simultaneously increasing its presence in the region.

As the U.S. and the Western world accelerate their efforts to decouple from China and find alternative suppliers for their markets, it is vital to analyze and study the markets that they diversify into, such as South East Asia. A diversification project that moves industries from mainland China into markets such as Thailand, Vietnam, or Malaysia will not be diversification since the infrastructure that supports industry, the export processing zones that incubate the industries have Chinese investments and play a significant role in the BRI. By moving industries into states that are large recipients of BRI financing and projects, the diversification project becomes moot. It turns into an indirect validation of China's BRI. Moreover, with favorable macroeconomic fundamentals, Vietnam, Thailand, Myanmar, and Cambodia have attracted increasing foreign direct investment from the West over the past decade or so. These investments have been going into export processing zones that house several Chinese enterprises.

The Beijing-funded Sihanoukville SEZ in Cambodia is a case in point.The SEZ is the country's biggest industrial park and is growing into one of Indochina's largest special economic zones – at more than 1,100 hectares, it houses around 100 Chinese-owned factories. The economic zone is jointly operated by Jiangsu Taihu Cambodia International Economic Cooperation Investment Company and Cambodia International Investment Development Group Company. The other salient feature of the project is the cable project that forms part of it. The Malaysia-Thailand-Cambodia (Sihanoukville) Submarine Cable is designed and deployed by Huawei Marine, recently renamed HMN Technologies. While several ASEAN states have not explicitly come out in favor of adopting Huawei's 5G, the entire region uses Huawei's submarine cables to move data across different states. This is extensive in the Malacca Strait, with Malaysia, Thailand, and Cambodia all using Huawei's technology.

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The Boten SEZ in Laos is another example of economic zones cultivated to absorb Chinese raw materials and enterprise. The Boten SEZ houses several Chinese companies and has connected regional provinces to the major cities of the country. However, China's debt-inducing trap lies in the roads that connect to the SEZ. For example, the Bokeo-Boten 176.3km expressway connecting China-Thailand-Laos, is expected to cost US$3.8 billion. That amounts to around $21 million per kilometer, which is way higher than Asia's highest of $11 million per kilometer in Dhaka.[5] In a similar vein, the China-Laos railway, a joint venture created to fund railway lines to export processing zones and regional provinces at an estimated cost of $6 billion has the potential to affect Laos' sovereignty by ceding land to China.[6] While the inflated costs are one part of the cause for concern, the other alarming challenge is the land for debt deal signed by the government of Laos. Adding insult to injury, the revenues generated by the SEZ to the Laotian government has not crossed $20 million. Given these bleak numbers, China acquiring a lion's share of the export processing zones and the roads and railway lines to it is not a distinct possibility.

As economist Jayant Menon, an international trade expert and visiting senior fellow at the ISEAS-Yusof Ishak Institute puts it,[7] "over the years Vietnam, Malaysia, and the Philippines turned out to be key transshipment points", in free trade agreements, around 40 percent to 60 percent of the product is mandated to be made in the listed country of origin, however, through transshipment deals such as the one that is widely present in Indochina, over 80 percent of the product is manufactured in China and the last point of export is used as the country of origin.

> ***China has successfully capitalized on emerging markets seeking investments, regardless of their place in the value chain. By skirting country of origin guidelines, China is able to avoid costly tariffs while simultaneously increasing its presence in the region.***

The Roads, Railway Lines and Bridges to China's Grand Strategy

Roads, railways lines and bridges constructed from a remote province to another with little foot traffic may be discounted as an endeavor to offload China's glut of raw materials. While this might be the case in mainland China, the rationale behind such projects in South East Asia could be multifold. One, the opportunity to connect to maritime routes. China's Malacca dilemma can be addressed by finding alternative routes to its supply chain, in particular its oil supply chain. Myanmar's Kyaukpyu SEZ provides the opportunity to reroute China's oil supply chain. Currently, China relies on an open Malacca Strait to source its oil. With the U.S. Navy's presence in the region, there is an ever looming threat to China's supply chain. To thwart this risk, China's state-owned enterprises have successfully leveraged the SEZ to be a catalyst for oil trade. Furthermore, the SEZ in Myanmar is highly reliant on Chinese funding due to the lack of "ceasefire diplomacy" on the part of other investors.[8] While the Cambodian port brought in Japanese investments to act as a hedge, the SEZ in Myanmar has limited options of foreign investment due to the prevailing sanctions and the revised policy of development agencies of Japan on supporting projects under the military dictatorship. Two, the Chinese state uses these projects to justify the deployment of its security forces.[9] In select regions of the world, this has taken the form of its national army being deployed, while in others it has been private security forces with strong ties to state-owned enterprises. In Myanmar, Laos, and Cambodia, private security agencies supervise the projects and the local security forces have little to no sway in the functioning of industries within export processing zones funded as part of the BRI.

Thailand is touted as a success story in the region with its strong macroeconomic framework. However, over the past five years, under the military leadership, the Thai government has welcomed Chinese investments into its infrastructure projects. The nation has expanded its partnership with China, from joint infrastructure projects to military exercises.[10] In particular, Thailand is currently home to Chinese projects that cost as high as a percentage of its GDP. The Bangkok-NongKhai high speed railway line will cost the Thai economy roughly 2 percent of its GDP. The project does not have the necessary footfall to reap the revenues to make up for the high costs. Moreover, the project will be cannibalizing the other train route to NongKhai developed by the government of Thailand. As it is, Thailand is one of the ASEAN members to allocate less than 1.5 percent of its GDP to military expenditure.[11] With rising costs from BRI projects, the situation may further deteriorate. Given the inflated costs of projects in CLMV countries, it is vital to ponder the connection between China's geo-economic ambitions and its security goals in the South China Sea. A significant drop in military budgets of nations in the region will assist China in solidifying its claims to the disputed waters of the South China Sea. Furthermore, the replacement of indigenous industries in the region limits the scope of revenue generation for the economies of ASEAN.

Policy Recommendations

The case of South East Asia's economic integration with China and the cost it bore to the economies of the region should be a lesson for economies of South Asia and other regions that have adopted the economic integration mechanisms part of the BRI. Nations such as Sri Lanka that have recently instituted economic zones and smart city projects into their BRI cooperation with China must be cognizant of the pitfalls of such cooperation. It is vital for frontier and emerging market economies to be wary of China's lending for export processing, deep sea ports and infrastructure projects that connect them to the provincial regions of the host country.

Furthermore, nations of the West and the Quad grouping that seek to diversify supply chains would have to stipulate stronger guidelines for country of origin tags. Diversifying supply chains to ASEAN would not be diversifying at all if its China's investments reaping returns through the use of SEZs. The Quad grouping should invest in the infrastructure of ASEAN to curb China's BRI getting a back door to the redesigned supply chains.

President Biden's proposal of Build Back Better, also known as B3W as an alternative to the BRI would have to consider these regional dynamics before embarking on the development of infrastructure in the global South. It would be myopic on the part of the West and the Quad to embark on an infrastructure building initiative without analyzing the intricate details of China's BRI and how it is woven into the economic architecture of different regions of the world, in particular in the highly economically integrated South East Asia.

As illustrated earlier, South East Asia, due to its geography and its history has become a hostage to great power politics. The leaders of the region should be wary of inflated projects and dumping of Chinese goods into their economies as they liberalize for foreign direct investments. Politically, the region should seek alternate investment avenues and rethink its strategy of hedging.

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Endnotes

1 *Weaponized Interdependence* explains how the broad structural features of the global economy enable some states while constraining others.

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3 Lo Kinling, "Debt-trap diplomacy? Report finds China can cancel loans if displeased," *South China Morning Post*, March 2021, https://www.scmp.com/news/china/diplomacy/article/3127705/debt-trap-diplomacy-report-finds-china-can-crunch-loans-if.

4 Several infrastructure projects that are part of the BRI have debt financing, with over 50 percent to be paid by the host government. The Xe-PianXe-Namnoy hydropower plant is an example of one such deal. The Lao-China HSR - Vientiane to Boten railway line is a debt for land deal.

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10 M.J. Woof,"Thailand land bridge project proposed," World Highways, 2021, https://www.worldhighways.com/wh8/news/thailand-land-bridge-project-proposed.

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