EUROPEAN **POLICY**BRIEF

COMPETING INTEGRATIONS IN SOUTHEAST ASIA

China in Southeast Asia: State-State Ties, State-Business Relations and Investment Flows in Malaysia

Since the introduction of the Belt Road Initiative (BRI) by President Xi Jinping in 2013, there has been a surge in investments by China into Southeast Asia. An important outcome of the BRI is that of growing ***state-state ties*** between China and Southeast Asian countries, particularly visible in Malaysia. Based on these state-state ties, enterprises owned by the governments of both countries have been employed to jointly mount projects, creating ***public-public partnerships***, though private investors also receive government support. In the process, diverse forms of ***state-business relations*** have emerged, with some ventures controversial in nature, with evidence of anomalies, while others have potentially productive outcomes.

Edmund Terence Gomez, September 2019

INTRODUCTION

Since 2013, President Xi Jinping's Belt-Road Initiative (BRI), escalated the phenomenon of 'state-state relations', leading to important changes in 'state-business relations' (SBRs), too. The BRI's primary objectives are to utilize excess production capacity in China to secure access to the region's energy and resources and nurture a network of economic inter-dependence involving countries in Asia and Europe. A key tool China has been utilizing to implement the diverse range of projects under the BRI are its state-owned enterprises (SOEs).

Southeast Asian countries have been the primary beneficiaries of greenfield-based investments related to the BRI. To ensure implementation of these mutually beneficial economic ties, fostered through active state-state relations, multi-national SOEs from China as well as government-owned enterprises in the region were employed, suggesting that novel forms of SBRs were emerging in Southeast Asia. Another factor informing the construction of SBRs is that of the political system of a country. In most Southeast Asian countries, characterized by extensive state intervention, state-state relations have facilitated investment flows from China for BRI-based projects to be implemented by Chinese SOEs.

EVIDENCE AND ANALYSIS

Malaysia is an interesting case study as it was quick to endorse the BRI, to tap into investment funds that would flow in from China. It was particularly keen in 2013 to find new sources of foreign direct investments to offset declining domestic investments.[1] As Figure 1 indicates, there was a surge in investments into Malaysia from China after 2013, particularly after then Prime Minister Najib Razak signed 14 memoranda of understanding with Chinese companies for what was officially termed as ‘economic cooperation’. In 2018, of Malaysia’s total foreign direct investments, those from China constituted 40 percent–the largest component–amounting to RM19.7 billion, or US$3.5 billion (*The Edge* 13 May 2019). These funds were channelled to implement numerous infrastructure and industrial-based projects around the country, with the largest ones indicated in Figure 2.[2] Not long later, President Xi described China’s tie with Malaysia as “being at its best”.[3]

Figure 1: Surge in Chinese investments into Malaysia after 2013

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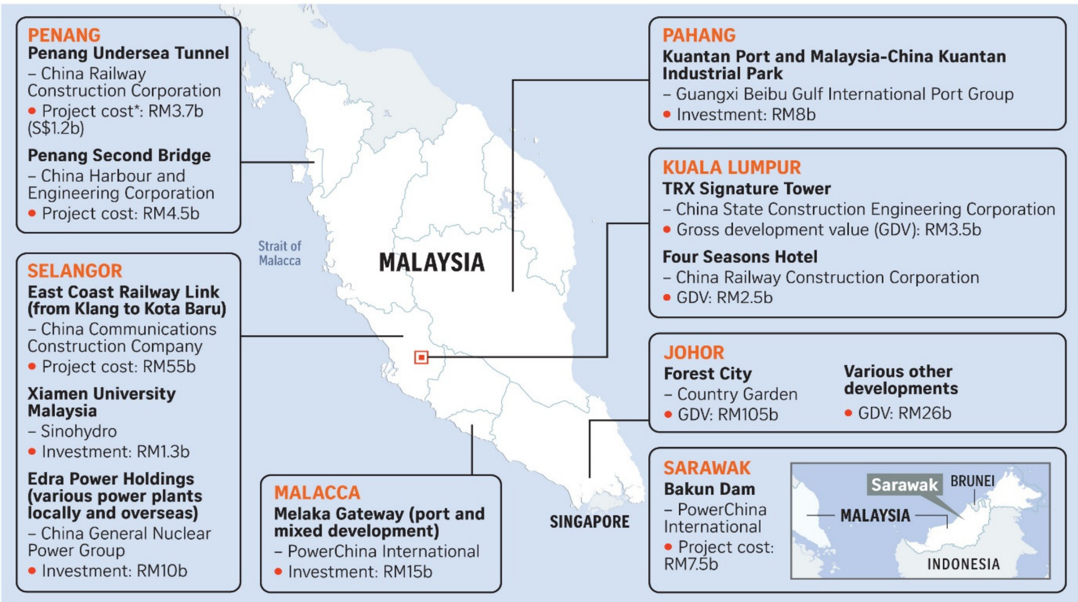
[1] One reason for this was the results of the general election in 2013 when the then ruling coalition, the *Barisan Nasional* (National Front), registered a fall in support. In response, the government introduced an ethnically-based discriminatory policy to muster political support from Malays, Malaysia’s majority ethnic group. However, this policy, based on, among other things, affirmative action in business, undermined domestic investor confidence. For an in-depth analysis on this issue, see Gomez and Mohamed Nawab (2020).

[2] This report is based on an assessment of data compiled of 90-odd companies from China that had invested in Malaysia. This assessment was first presented at the CRISEA-EU dissemination conference on 9 July 2019 in Kuala Lumpur, entitled ‘Development & Transformation in Southeast Asia: The Political Economy of Equitable Growth’. For a report on the findings based on this research, see *South China Morning Post* (9 July 2019). See also: https://www.scmp.com/news/asia/southeast-asia/article/3017880/beware-grabbing-hands-chinese-projects-malaysia-economist

[3] Rachel Lau, ‘China’s Belt and Road: What’s in it for Malaysia?’, *Borneo Post*, 3 September 2017. http://www.theborneopost.com/2017/09/03/chinas-belt-and-road-whats-in-it-for-malaysia/

Figure 2: Key China-Related Projects in Malaysia

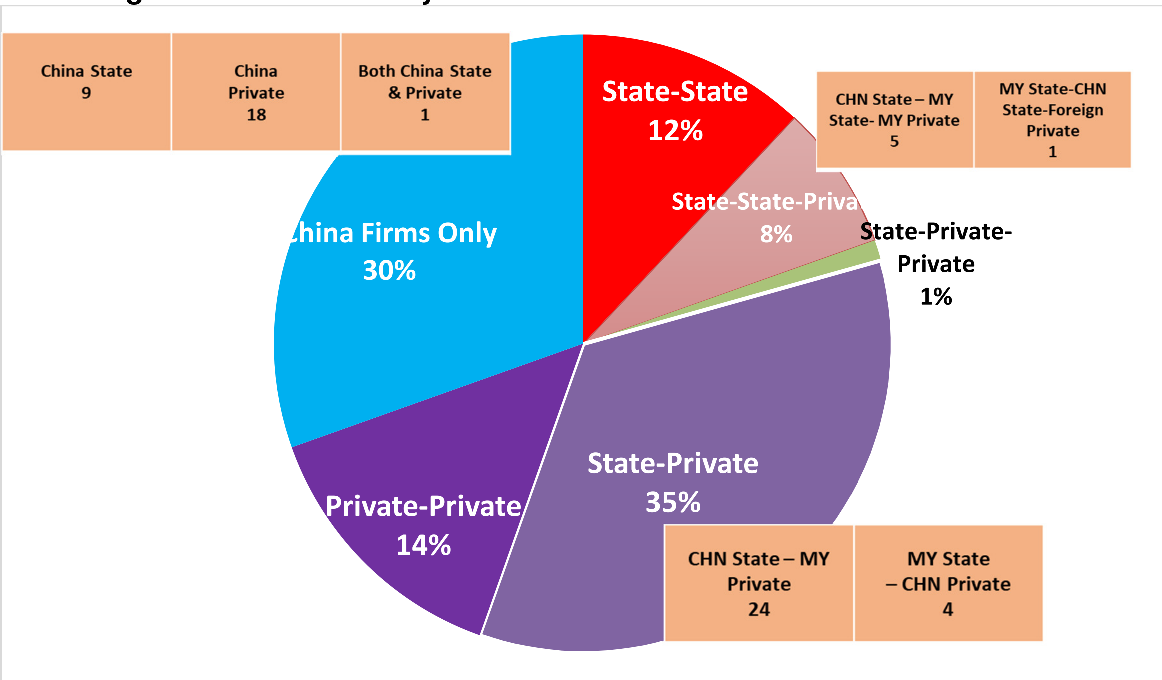


Source: *The Straits Times,* 7 May 2017

An in-depth study of China's investments in Malaysia uncovered 92 SOEs and private firms which had created different sorts of SBRs that can be classified as 'state-state', 'state-state-private', 'state-private' and 'state-private-private' (see Figure 3). In some cases, private firms from China and Malaysia forged 'private-private' ties, through joint-ventures. In other projects, private enterprises, as well as SOEs, from China ran ventures without the participation of Malaysian companies. A majority of these investments were channelled to infrastructure and construction-based projects. These diverse SBR forms have led to different outcomes, some predatory in nature, reflecting elements of rent-seeking in key projects, some more developmental in nature, resulting in the creation of infrastructure that facilitates trade as well as the incorporation of new industries that nurture technological progress.

A large number of these projects were implemented by multi-national SOEs from China in collaboration with government-linked companies (GLCs) from Malaysia; in some cases, privately-owned firms were included in these joint-ventures. Privately-owned companies from China had also begun actively investing in Malaysia, though not necessarily in BRI-linked projects, reinforcing the view that this plan was inaugurated to support China's longstanding 'Go Out' policy, introduced in 1999. These Chinese private firms operating in Malaysia have a marked presence in the industrial and manufacturing sectors; in some cases, joint-ventures were created between them and Malaysian companies. This suggested that state-state relations between China and Malaysia had opened avenues for private firms from both countries to venture into business areas that can contribute to productive economic outcomes, including generating employment and creating new products and services.

Figure 3: China in Malaysia: Different forms State-Business Relations



New State-Business Relations, New Trends

However, this new trend in the structure of State-Business Relations draws attention to a crucial question: what happens when huge State-Owned Enterprises that function as Multinational Companies forge business ties with Government Linked Companies to implement major projects conceived by the governments of China and Malaysia? One key finding is that of a shift from public-private partnerships to ***public-public partnerships***, following the mandate by two governments to companies they own to jointly implement projects. In these public-public partnerships, where projects are implemented by SOEs and GLCs, there are no contestations with privately-owned companies as governments decide how projects are shaped. Issues concerning funding of these projects appear to have little bearing in public-public partnerships as they are financed primarily by China-based institutions. However, while financing is available from China, it can backfire on the recipient country if the loan taken cannot be repaid if the project does not generate the expected revenue. For this reason, joint-ventures, where the risks are shared between both countries, appear more beneficial for the recipient country.

Investment decision-making patterns differ in these public-public partnerships as governments are not dependent on private firms to take up policy incentives. Governments can shape projects in their own way, without worrying if private firms will respond to incentives to invest. In these public-public partnerships, the two governments can also determine how–or if–private sector involvement is to be handled in projects funded by them. The choice of private firms for projects is, normally, decided by the host government, depending on the project involved.

Although SOE-GLC links, constituting joint foreign-domestic business ownership, are common in state-state, state-state-private and state-private ties, power is not equitably distributed between these enterprises. Decision-making authority lies primarily with the large MNC-type SOE, suggesting ***a shift in structural power***, from private firms to the Chinese government. One reason for this shift is that China has extraordinary outreach and a potentially huge impact on developing economies by funding major projects, implemented by SOEs with technological know-how to deliver results of high value. Importantly too, through these public-public partnerships, Chinese SOEs gain entry into numerous key sectors in developing economies.

However, important variations exist in terms of investment patterns by enterprises from China. As Figure 3 indicates, private firms from China along with GLCs from Malaysia jointly run projects. A large number of companies from China, both SOEs and private firms, also function alone in Malaysia and in a range of sectors. Big businesses, though not necessarily always as capital controllers, still exist among Chinese firms, seen particularly in the digital economy sector. In this sector, when private firms own enormous technical knowledge, they can exert much power over foreign governments by deciding if they should invest. This is seen in the case of companies such as Alibaba, Tencent and Huawei. Alibaba, for example, was heavily courted by the Malaysian government to develop a Digital Free Trade Zone (DFTZ). In the industrial sector, one private-private tie that benefited Malaysia occurred when China's Geely teamed up with DRB-Hicom to revive the ailing Proton car project.

In these different forms of state-business ties, one core feature is that of ***financial-industrial linkages***, with financing by Chinese SOEs. A key finding is that funding of projects, including those that are BRI-based, was not by the multi-lateral-based Asian Infrastructure Investment Bank (AIIB), but by policy-based banks such as the Export-Import Bank of China, China Development Bank and China Construction Bank. The role of China's policy-based banks indicates the endeavour by this government to ensure that its foreign developmental-based projects proceed.

The institutional architecture that shapes policy planning in these projects is important as it provides insights into how the government–in some cases, both governments–shape or re-shape the way production networks and supply chains are created, an outcome expected of large-scale projects. These networks and supply chains, led by Chinese SOEs and involving small- and medium-scale enterprises (SMEs) in Malaysia, can have a bearing on the extent of transfer of technology in key sectors. In projects led by SOEs, with heavy government backing that allows for spending in costly R&D, this can lead to important structural transformation. Malaysian companies could well employ the newly-acquired knowledge to develop their own expertise in key sectors, allowing them to move up the technological chain.

Policy Implications and Recommendations

The rise of SOE-GLC ties, emerging from a surge in fund flows from China into Southeast Asia after the introduction of the BRI, draws crucial attention to ***changing forms of government intervention***, clearly manifested in new SBR systems. There are potentially positive outcomes from these state-state ties and re-configured SBRs, including:

a) construction of crucial infrastructure that can facilitate trade;
b) promotion of key industries to expedite industrialization, particularly in under-developed Indo-China;
c) nurturing of SMEs in Southeast Asia, an extremely imperative endeavour as they constitute the largest segment of the corporate sector in a country. In Malaysia, for example, SMEs comprise 98% of the corporate sector;
d) financing of R&D and expensive–and potentially risky–technologically-based industries that the private sector would fear treading into; and
e) creation of globally-based supply chains and production networks that foster the rise of entrepreneurial domestic firms.

However, in these new SBRs, there are grave policy concerns as there are unclear boundaries between these governments and their SOES/GLCs, with little evidence of an 'arms-length' relationship between them.

Emerging Southeast Asia may lack a well-conceived institutional architecture shaping investment flows through a well-defined and appropriate institutional setting to ensure effective industrial development. This appears to be a problem in Malaysia and possibly also in the Indo-China countries, Indonesia and the Philippines.

RESEARCH PARAMETERS

Competing Regional Integrations in Southeast Asia (CRISEA) is an interdisciplinary research project that studies multiple forces affecting regional integration in Southeast Asia and the challenges they present to the peoples of Southeast Asia and its regional institutional framework, ASEAN.

CRISEA innovates by encouraging ‘macro-micro’ dialogue between disciplines: global level analyses in international relations and political economy alongside socio-cultural insights from the grassroots methodologies of social sciences and the humanities.

Coordinated by the Ecole française d’Extrême-Orient (EFEO) with its unique network of ten field centres in Southeast Asia, the project brings together researchers from seven European and six Southeast Asian institutions, with three objectives:

1. Research on regional integration
Multiple internal and external forces drive regional integration in Southeast Asia and compete for resources and legitimacy. CRISEA has identified five ‘arenas of competition’ for the interplay of these forces, investigated in the project’s five research Work Packages. It further aims to assess the extent to which they call into question the centrality of ASEAN’s regional model.

2. Policy relevance
CRISEA reaches beyond academia to engage in public debate and impact on practitioners in government and non-government spheres. By establishing mechanisms for dialogue with targeted audiences of policymakers, stakeholders and the public, the project furthers European science diplomacy in Southeast Asia and promotes evidence-based policymaking.

3. Networking and capacity-building
CRISEA reinforces the European Research Area (ERA) in the field of Asian Studies through coordinated EU-ASEAN academic exchange and network development. It connects major research hubs with emerging expertise across Europe and Southeast Asia. CRISEA also promotes participation of younger generation academics in all its activities, notably policy dialogues.

PROJECT IDENTITY

PROJECT NAME	Competing Integrations in Southeast Asia (CRISEA)
COORDINATOR	Andrew Hardy, EFEO, Paris, France, hardyvn25@yahoo.com.
CONSORTIUM	Ecole française d’Extrême-Orient – EFEO – Paris, France University of Hamburg – UHAM – Hamburg, Germany University of Naples l’Orientale – UNO – Naples, Italy Institute of Social and Political Sciences – ISCSP - Lisbon, Portugal University of Lodz - UL – Lodz, Poland University of Oslo – UiO – Oslo, Norway University of Cambridge – Cam – Cambridge, UK Chiang Mai University – CMU – Chiang Mai, Thailand The Centre for Strategic and International Studies - CSIS – Jakarta, Indonesia Ateneo de Manila University – ADMU – Quezon City, Philippines University of Malaya – UM – Kuala Lumpur, Malaysia Vietnamese Academy of Social Sciences – VASS – Hanoi, Vietnam The University of Mandalay – MU – Mandalay, Myanmar
FUNDING SCHEME	H2020 Framework Programme for Research and Innovation of the European Union – Research Innovation Action (RIA) – Europe in a changing world, Engaging together globally

DURATION November 2017 – October 2020 (36 months).

BUDGET EU contribution: €2,500,000.00

WEBSITE www.crisea.eu

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FURTHER READING

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