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The Belt and Road Initiative in Malaysia: Case of the Kuantan Port

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EXECUTIVE SUMMARY

- Notwithstanding the much-publicised cancellation or suspension of China-related mega-projects, various private sector-funded projects are proceeding as planned. The expansion of Kuantan Port through a strategic partnership between IJM Malaysia and China's Guangxi Beibu Gulf International Port Group is a case in point.
- This strategic partnership also invested in the Malaysia-China Kuantan Industrial Park (MCKIP), which has a sister park in China under the ambit of the Five-Year Program for Economic and Trade Cooperation between Malaysia and China (2013-2017). MCKIP is also an important component of the East Coast Economic Region (ECER), covering 51 percent of Peninsular Malaysia. The ECER was formulated to reduce the development gap between the east and west coast of Peninsular Malaysia.
- Co-investments in both port and park are creating the demand for the expanded port facilities. Going forward, the aspired shift towards transshipment cargo handling for Kuantan Port will require more investments, including FDI, in the east coast region to develop more manufacturing activities to generate additional demand for port services. Continuous improvements in port efficiency, especially in the clearance of ships and goods are essential, given the intensification of port competition in the region with more new and expanded ports emerging in the near future.

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INTRODUCTION

Media attention on the Belt and Road Initiative (BRI) in Malaysia since the 14th General Election (GE14) in May 2018 has mainly focused on the mega projects that were cancelled or put on hold.¹ This has generally given rise to the false impression that China's infrastructure projects in the country are financed primarily by Malaysian government-guaranteed loans alone, leading to their vulnerability to be curtailed due to the size of the government debt. In reality, there are many China-related projects in Malaysia which are funded by the private sector, including in manufacturing and services as well as infrastructure expansion projects such as the Kuantan port.

Kuantan port is a privatised port, located on the eastern coast of Peninsular Malaysia in the state of Pahang, facing the South China Sea (see Figure 1). Geographically, the port serves the shortest shipping route from Malaysia to China, and is a mere 45 minutes away by flight from Kuala Lumpur. Alternatively, it is a three-hour drive away from Kuala Lumpur, via the Kuala Lumpur-Karak Expressway. It is managed by Kuantan Port Consortium Sdn. Bhd. (KPC), which is jointly owned by IJM Corporation Berhad, a publicly listed company on Bursa Malaysia (60 percent) and Beibu Gulf Holding (BGH, Hong Kong) Co. Ltd (40 percent), with the Malaysian government having a special rights share.² BGH belongs to China's Guangxi Beibu Gulf International Port Group Co. Ltd, a state-owned enterprise (SOE) dealing with the construction and operation of ports, railway and roads.³ In 2013, it operated four ports in southern China, namely Fangchenggang port, Qinzhou port, Tieshan port and Beihai port.⁴ These four ports reportedly handled about 200 million freight weight tonnes (fwt) of cargo in 2012.⁵ Although Kuantan port had excess port capacity of about 35 per cent in 2014, the entry of a strategic partner from China led to expansion plans⁶ that will double its capacity from 26 million to 52 million fwt and transform the port from a feeder to a deep water port.⁷ Annual container volume is expected to increase from 150,000 TEUs to 1.5 million TEUs. The port exports mainly bulk cargo such as timber, petroleum and palm oil products from the surrounding region, with exports being greater than imports prior to the expansion of the port.

This article examines the expansion of Kuantan port and its strategy to create additional demand for the new port's facilities as well as key challenges in moving forward.

EXPANSION OF KUANTAN PORT: PROGRESS THUS FAR

The new deep-water terminal is being constructed progressively in three different phases (Table 1). IJM Corporation Berhad and its Chinese partner are investing RM3 billion for capital dredging, reclamation works to create new development land, construction of new berths, operational buildings, facilities, equipment and machinery as well as the internal infrastructure. This is funded by a loan from a local bank and internally generated funds. KPC is given an extension of its port concession for 30 years from 2015 to 2045 for the development, operation and management of the existing Kuantan Port and the new terminal. It will be granted another 30 years' concession when it completes Phase 2 development of the new terminal by Dec 31, 2039 (Table 1).

An important component in the expansion of the port is the construction of the 4.63 kilometres long breakwater (Figure 2), which started in 2013, with a one-off funding of

RM1 billion from the Federal government, using French technology.⁸ The breakwater is essential for creating a sheltered basin that will enable the berths to operate throughout the year, including the monsoon season. It is also built to endure, subject to impending changes in sea level in the long-term, with climate change.⁹

Table 1. Three Phases of Development of the Deep Water Terminal at Kuantan Port

Terminal Phase 1A	Terminal Phase 1B	Terminal Phase 2
<ul style="list-style-type: none"> • Commence Operations: Q2 2018 • Berth: 400 m • Basin depth: 16m • Cargo Yard: 20 Hectares • Max Ship Size: 150,000 DWT 	<ul style="list-style-type: none"> • Commence Operations: Q2 2019 • Berth: 600 m • Basin depth: 16m • Dry Bulk Yard: 22.5 Hectares • Max Ship Size: 150,000 DWT 	<ul style="list-style-type: none"> • Berth: 1,000m • Basin Depth: 18m • Container Terminal: 47 Hectares • Max Ship Size: 200,000 DWT

Source: Kuantan Port Consortium Sdn. Bhd (KPC).

At the time of interviews being carried out at the port, Phase 1A is nearing completion, with ongoing testing of the facilities and hence the port expansion plans are progressing as planned.¹⁰

EXPANSION OF THE HINTERLAND

Infrastructure projects are supply driven and built ahead of projected demand. Demand side strategies therefore play an important part in the utilization of new infrastructure. Kuantan port's expansion is planned in conjunction with the creation of demand for the expanded capacity. This is made possible as the key investors of the port are also key investors in the development of the Malaysia-China Kuantan Industrial Park (MCKIP), which has a sister park in China under the ambit of Five-Year Program for Economic and Trade Cooperation between Malaysia and China (2013-2017).¹¹ IJM Land holds 40 percent equity in the Malaysian consortium while Kuantan Pahang Holdings Sdn. Bhd. and Sime Darby Property together hold 30 percent and the Pahang State Government holds the remaining 30 per cent. The Chinese consortium holds 49 percent in this joint venture with the Malaysian consortium, with Guangxi Beibu Gulf International Port (GBGIP) Group holding 95 percent and Qinzhou Investment Company holding the remaining 5 percent.¹² Guangxi was tasked to introduce investors for a steel mill plant, an aluminium processing plant and an edible oil processing plant in MCKIP, when the port's expansion plans were announced in 2013.¹³

Subsequently in 2014, GBGIP formed a joint venture with Guangxi Sheng Long Metallurgical Co. Ltd. to establish Alliance Steel (M) Sd. Bhd. to become the largest investor in MCKIP.¹⁴ Alliance Steel (AS) occupies 710 acres of land in the park or approximately 60 percent of the land in MCKIP1, constituting the first parcel of land in the park's development.¹⁵ It has invested RM5.6 billion in the building of the steel factory and created jobs for 2,600 Malaysian employees to date. The integrated steel mill, using blast

furnace technology, has the capacity to produce 3.5 million tonnes of wire rod, steel bar and H-beam a year. It is expected to contribute towards 7.0 million tonnes of cargo throughput for Kuantan port, importing mostly the raw materials for steel processing and exporting steel products.¹⁶ The raw materials needed for the production of steel are procured from outside resource-scarce China, such as Australia and Brazil, while limestone is obtained from within Malaysia itself.¹⁷ Other imports include the capital equipment and intermediate inputs used in the building of the steel factory. The steel mill is already operational and is expected to export more than one million tonnes of steel products in 2018, to other ASEAN countries

Based on this business model of mutual investment in both port and park, Guangxi helps the joint venture partnership promote the park in China, leading to a preponderance of Chinese investors in the park. These inflows can be attributed to both push and pull factors since China's manufacturers have been gradually shifting their production offshore in response to domestic pressures such as increasing costs, excess capacity as well as increasingly stringent environmental controls. Developing host economies such as Malaysia pursue inward investments, including investments from China, with fiscal as well as non-fiscal incentives. In particular, a tax holiday of up to 15 years is provided at MCKIP, together with attractive land prices. There are also investors from outside China, such as Singapore and Australia.¹⁸ To date, about 80 percent of the land in MCKIP1 has already been taken up by investors, while 30 percent of the land in MCKIP2, which is the second parcel of park development, has already been earmarked for an investor. The main products manufactured in the park are steel, porcelain ware and ceramic tiles, spun concrete piles for manufacturing and battery manufacturing for energy efficient vehicles.¹⁹ The current trade war between the US and China has apparently stirred interest for more of China's manufacturers to relocate their production to Southeast Asia, including Malaysia. It would appear that China's investment will continue to dominate at MCKIP. The products produced at the park will inevitably have an export component since China is used to producing on a large scale, while Malaysia's domestic market is relatively small.²⁰ Malaysia also aims to gain technology transfer from these projects.

Apart from the park, the East Coast Economic Region (ECER), which covers 51 percent of Peninsular Malaysia, is also targeting investments in oil, gas, and petrochemicals, tourism, agriculture and human capital development. The development of this zone will further expand the hinterland of Kuantan port beyond Kuantan itself, though the physical connectivity with the port will not be as well placed as MCKIP.

CHALLENGES IN MOVING FORWARD

Currently, Kuantan port is ranked 7th out of the 14 ports listed in the 2017 Annual Transport Statistics from the Ministry of Transport, in terms of total cargo throughputs, and second in terms of dry bulk cargo. This is due primarily to the economic activities in the hinterland, which deals more with resource-based activities as well as the berth depth of the port which could not accommodate bigger vessels prior to its expansion.

In the first phase of expansion, the focus is still on bulk cargo based on the berth constructed or that will be constructed. Since the port serves essentially the east coast hinterland, it will complement the more established ports on the west coast which have established linkages with the west coast hinterland. The original intent of linking the east to the west coast through the East Coast Rail Link (ECRL) is uncertain, and the project is being reviewed. Even if it does materialise, the freight costs of the new connectivity, unless subsidized by the government, will deter possible substitution effects from taking place. Moreover, detailed studies have to be conducted to provide empirical evidence on the cost structure of the ECRL and the amount of government subsidy needed for a viable freight cost and whether such a subsidy is affordable for the government.

The port aims to shift progressively towards transshipment business with the soon to be established Free Commercial Zone.²¹ Although phase 2 expansion is for container cargo, there is currently excess capacity for container throughput, which can only be utilized when the approved investments in the MCKIP are fully operational. Reduction in the port's excess container capacity will therefore require a decrease in the time lag from investment approval to the construction of manufacturing facilities that will lead towards the anticipated exports needed for balancing the initial import demand in terms of capital, intermediate inputs and raw materials. Ultimately, a complex host of factors influence port choice behaviour which will affect the viability of the intended shift towards transshipment cargo. These include the hinterland production, the trade structure and the trade balance, the port efficiency which includes more than port charges, as well as heightened uncertainty due to the growing container shipping market consolidation.²² More private investments, including FDI, from beyond the park are needed for generating more manufacturing activities to create the demand for port services, while port efficiency requires a rapid digitalization of the port for swifter clearance of ships and cargo on a single platform. It remains to be seen if the long awaited government initiative, the U-customs, which is supposed to provide a fully integrated end-to-end solution based on a single window concept for cargo clearance, will materialise in 2019 as planned, after multiple delays.

CONCLUSION

Overall, the expansion of Kuantan port has proceeded according to plan. The expansion in port capacity is accompanied by increasing demand for the expanded facilities due to complementary investments of the private port operator in both the port and MCKIP. Hence, it is the combined commercial interests of the Malaysian and Chinese partner which are ensuring the viability of the new expanded port. While this explains the prevalence of China's investments in the park, diversifying the sources of investments in the park will reduce the dependency on a dominant source. Enhancing the investment climate beyond the park to the rest of the ECER and continuously improving port efficiency are essential for Kuantan port's aspired shift towards transshipment goods, given the intensification of port competition in the region with more new and expanded ports emerging in the near future.

¹ According to Financial Times (3 September 2018), three oil and gas line projects have been cancelled while the East Coast Rail Link (ECRL) project has been put on hold while it is being reviewed. See “Malaysia cancels China-backed pipeline projects”, 9 September 2018, <https://www.ft.com/content/06a71510-b24a-11e8-99ca-68cf89602132> <Accessed 22 November 2018>.

² See “Shareholders”, n.d., http://www.kuantanport.com.my/en_GB/about-us/shareholders/ <Accessed 22 November 2018>.

³ News Flash, IJM Corporation, “Port Play”, 6 February 2013, <https://klse.i3investor.com/files/my/ptres/res13543.pdf> <Accessed 22 November 2018>.

⁴ See <http://www.seatrade-maritime.com/news/asia/guangxi-beibu-to-buy-40-stake-in-kuantan-port.html> <Accessed 22 November 2018>.

⁵ See “Kuantan Port to make a big splash”, 16 February 2013, <http://www.starproperty.my/index.php/articles/property-news/kuantan-port-to-make-a-big-splash/?search=H> <Accessed 22 November 2018>.

⁶ Based on Transport Statistics from the Ministry of Transport, about 17 million fwt of cargo was exported through Kuantan port in 2014.

⁷ “Kuantan Port: Expanding the Possible”, n.d. at <http://www.kuantanport.com.my/mediafiles/kpc-english-FA.pdf>. See Page 2. <Accessed 22 November 2018>.

⁸ See ECER. Media Room. “Kuantan port expansion: A Game Changer”. 7 September 2013. https://www.ecerdc.com.my/en/media_releases/kuantan-port-expansion-a-game-changer/ <Accessed 29 November 2018 and personal communication during interview with the Port on 30 October 2018. Interview with Economic Planning Unit (EPU) on 21 November 2018.

⁹ Oceanographers have estimated the steric sea level (SSL) rise in the South China Sea to be 6.7, 10.0, and 15.3 cm under the three scenarios by the end of the 21st Century. See Huang Chuanjiang, Qiao Fangli, 2015. Sea level rise projection in the South China Sea from CMIP5 models. *Acta Oceanologica Sinica*, 34(3): 31–41, doi: 10.1007/s13131-015-0631-x

¹⁰ Interview at Kuantan port on 30 October 2018.

¹¹ The sister park in Guangxi China is the Malaysia Qinzhou Industrial Park (CMQIP). MCKIP is accorded a national park status as it is a bilateral Malaysia-China government-to-government collaboration.

¹² HKTDC, 2017. “Prospects for the Malaysia-China Kuantan Industrial Park and Kuantan Port”. <https://hkmb.hktdc.com/en/1X0AAOCO/hktdc-research/Prospects-for-the-Malaysia-China-Kuantan-Industrial-Park-and-Kuantan-Port> <Accessed 29 November 2018>.

¹³ News Flash, IJM Corporation, “Port Play”, 6 February 2013, <https://klse.i3investor.com/files/my/ptres/res13543.pdf> <Accessed 29 November 2018>.

¹⁴ Alliance Steel, <http://alliancesteel.com.my/gsjj> <Accessed 29 November 2018>.

¹⁵ See the three parcels of land for investors in MCKIP in the Kuantan port web-site, http://www.kuantanport.com.my/en_GB/industrial-area/mckip/ <Accessed 29 November 2018>.

¹⁶ “A look behind Kuantan's controversial 'Great Wall of China'”, Star Online 30 September 2018, <https://www.thestar.com.my/news/nation/2018/09/30/alliance-steel-speaks-up-after-wall-stir/> <Accessed 29 November 2018>.

¹⁷ Interview at Alliance Steel, 30 October 2018.

¹⁸ Interview at IJM, 29 October 2018.

¹⁹ “Trade War Adds FDI Lure to Kuantan”, Focus, 1 October 2018, http://www.kuantanport.com.my/en_GB/trade-war-adds-fdi-lure-to-kuantan/ <Accessed 29 November 2018>.

²⁰ Interview at IJM, 29 October 2018.

²¹ http://www.kuantanport.com.my/en_GB/trade-war-adds-fdi-lure-to-kuantan/, Op.cit. Page 21.

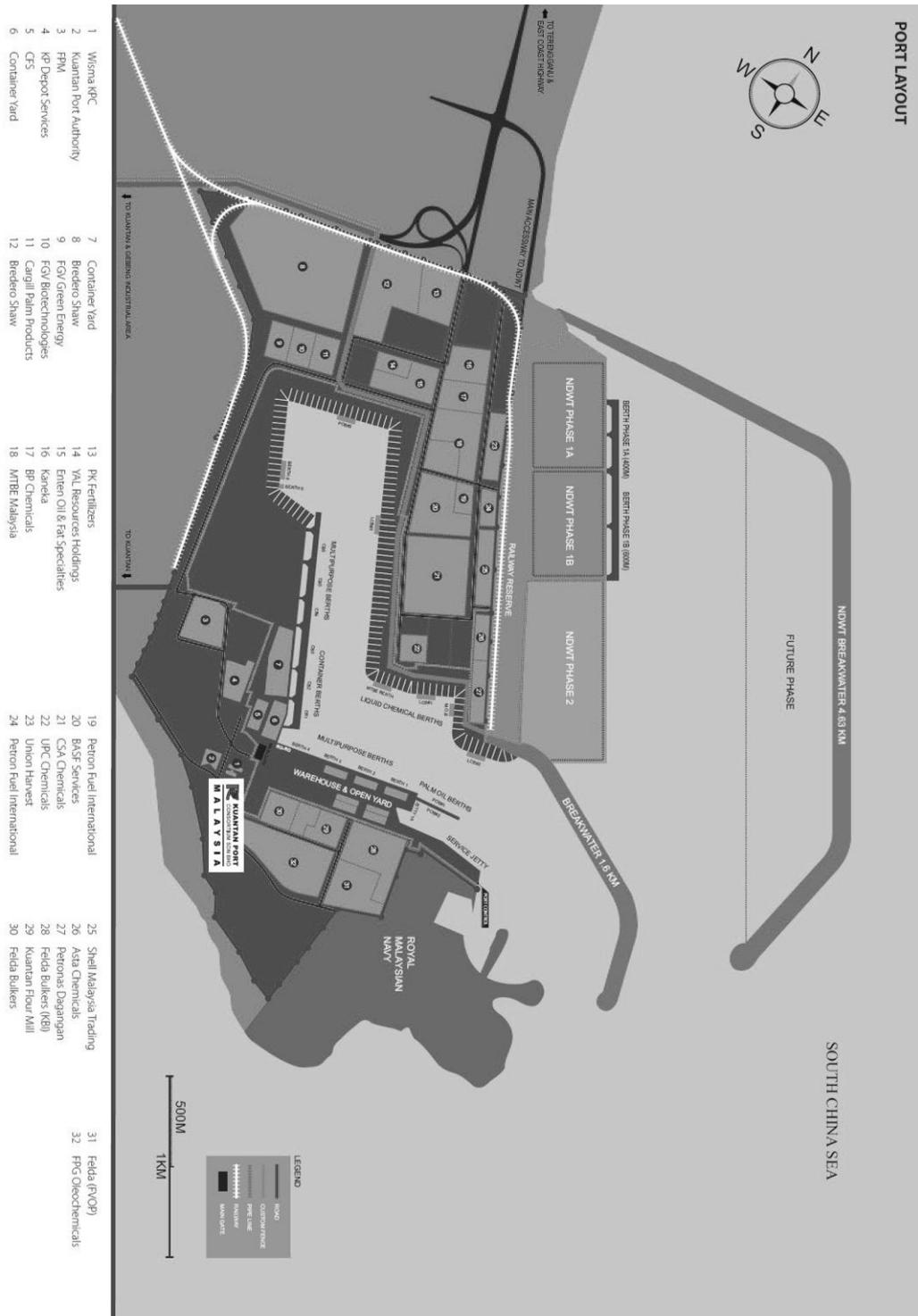
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https://ink.library.smu.edu.sg/lkcsb_research/3235 <Accessed 30 November 2018>. UNCTAD, 2018. Market consolidation in container shipping: what next?
https://unctad.org/en/PublicationsLibrary/presspb2018d6_en.pdf <Accessed 30 November 2018>.

Figure 1. Location of Kuantan Port



Source: Kuantan Port

Figure 2. Expansion of Kuantan Port



Source: Kuantan Port

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