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PERSPECTIVE

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The Belt and Road Initiative in Southeast Asia after COVID-19: China's Energy and Infrastructure Investments in Myanmar

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This picture taken on February 8, 2020, shows a part of the first rail line linking China to Laos, a key part of Beijing's 'Belt and Road' project across the Mekong, in Luang Prabang. From an artificial island in Sri Lanka to a bridge in Bangladesh and hydropower projects in Nepal and Indonesia, China's trillion-dollar Belt and Road plan is stuttering under the effects of the deadly coronavirus. Photo: Aidan JONES, AFP.

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EXECUTIVE SUMMARY

- Regardless of its eventual scale, the Belt and Road Initiative (BRI) will likely remain a cornerstone of China's foreign and economic policies, with an increased strategic focus on Southeast Asia. Energy and transport infrastructure investments will remain its key priority.

- The ASEAN market has become more important to China's BRI since the onset of the COVID-19 pandemic. Regional policymakers should take on a gatekeeper role and step up third-party scrutiny of BRI investments, as unsustainable ones will undermine economic recovery.

- Considering the divergences in environmental, social and governance (ESG) risks as well as security risks in Southeast Asia, smaller infrastructure projects will likely be more commercially viable than megaprojects.

- Increasing investment under the BRI could increase Southeast Asia's economic reliance on China, and reshape existing alliance patterns in the region.

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INTRODUCTION

Since its launch in 2013, China's Belt and Road Initiative (BRI) has stirred intense international debate over its political-economic impacts and a wide range of associated risks. Chinese spending on the initiative has slowed since 2018, and lockdowns during the COVID-19 pandemic have further worsened the already-significant delays in BRI infrastructure projects, amid geopolitical tensions. Regardless of its eventual scale, the BRI will likely remain a cornerstone of China's foreign and economic policies, with an increased strategic focus on Southeast Asia. Post-COVID economic pressures and the demand for infrastructure investment will drive ASEAN member states to work more closely with China. The question here is whether the parties involved can work together to achieve a win-win result.

GROWING INFRASTRUCTURE INVESTMENT GAP

Infrastructure investment is crucial to the economic growth and development of ASEAN member states. According to the Asian Development Bank (ADB), US$3 trillion of climate-adjusted investments will be needed from 2016 to 2030 to maintain the current development momentum in Southeast Asia.[1] Although these investment needs vary by sector, energy[2] is the largest, accounting for 56 per cent of the total projected investment need, followed by transport's 32 per cent. However, it is difficult for existing financial institutions, including the World Bank and the ADB, to fill this funding gap.[3] ADB data indicate that there is an annual investment need of US$210 billion, but infrastructure spending in the region was only US$55 billion in 2018. This gap is set to increase due to the ripple effect of COVID-19 on Southeast Asian economies.

In general, to meet their growth objectives, ASEAN member states will have to attract more infrastructure investment, especially in their energy sectors.[4] However, according to the Brookings Institute, traditional Western investments in Southeast Asia are either not keeping up with the region's needs or are turning away from infrastructure.[5] Although the barriers to investment in Southeast Asian infrastructure are the result of many factors, the most prominent ones are environmental, social and governance (ESG) risks.

This gap leaves room for more BRI investment in Southeast Asia. These outward BRI investments are also important in addressing a wide range of challenges faced by China, including slumping economic growth, domestic overcapacity and overproduction, the relatively backward development of western China, and the political instability and security of 'neighbourhood' regions near China.[6]

THE GROWING ROLE OF ASEAN IN THE BRI

China's economic ties with ASEAN member states have remained solid, even as COVID-19 continues to batter global trade and investment. In 2020, China's trade surplus recorded a 27% increase from 2019. Chart 1 shows that ASEAN has replaced the EU as China's top trading partner in 2020. Changes in trade patterns indicate that China has been leaning increasingly on the ASEAN market amid the pandemic disruption and increased geopolitical tensions.

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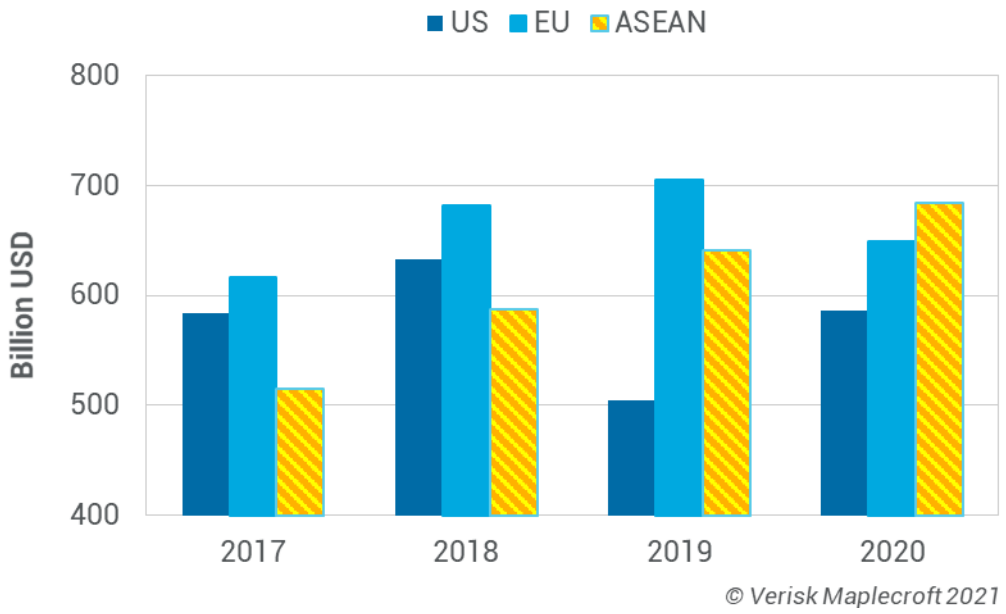
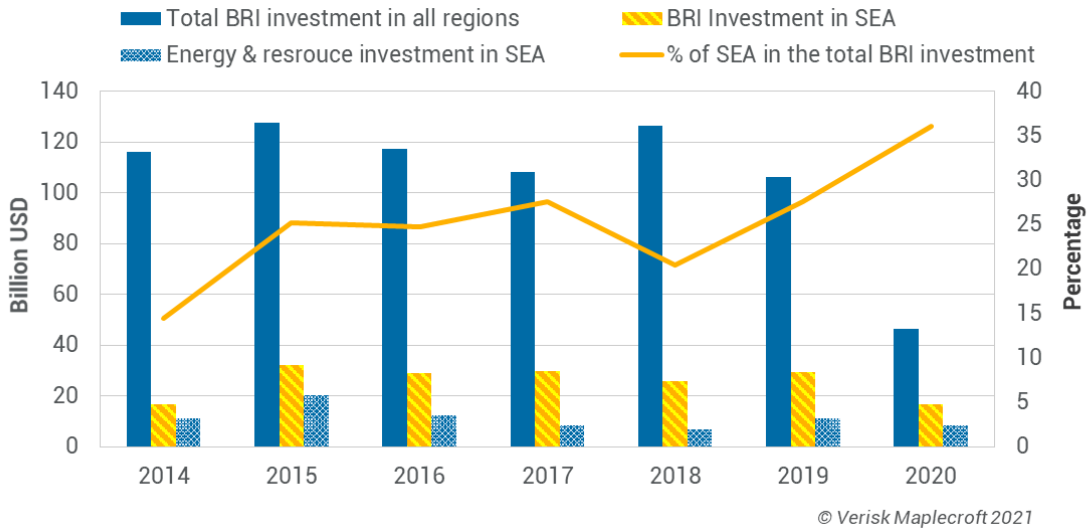
Chart 1: China's Top Trading Partners (2017 to 2020)



Source: Factset 2021

As shown in Chart 2, BRI investments[7] in Southeast Asia grew from US$16.8 billion in 2014 to US$29.3 billion in 2019, accounting for 27.6 per cent of all BRI investments worldwide. In these six years, construction contracts made up 46.2 per cent of BRI investments in Southeast Asia. Energy and resource[8] is the largest sector, accounting for 42.9 per cent, followed by transport's 31.7 per cent. Despite a sharp drop in total BRI investments in 2020, Southeast Asia (US$16.9 billion) became the BRI's largest investment destination, accounting for 36 per cent of the total investment (see Chart 3).

Chart 2: The Trend of BRI Investment in Southeast Asia (2014-2020)



Source: AEI 2021

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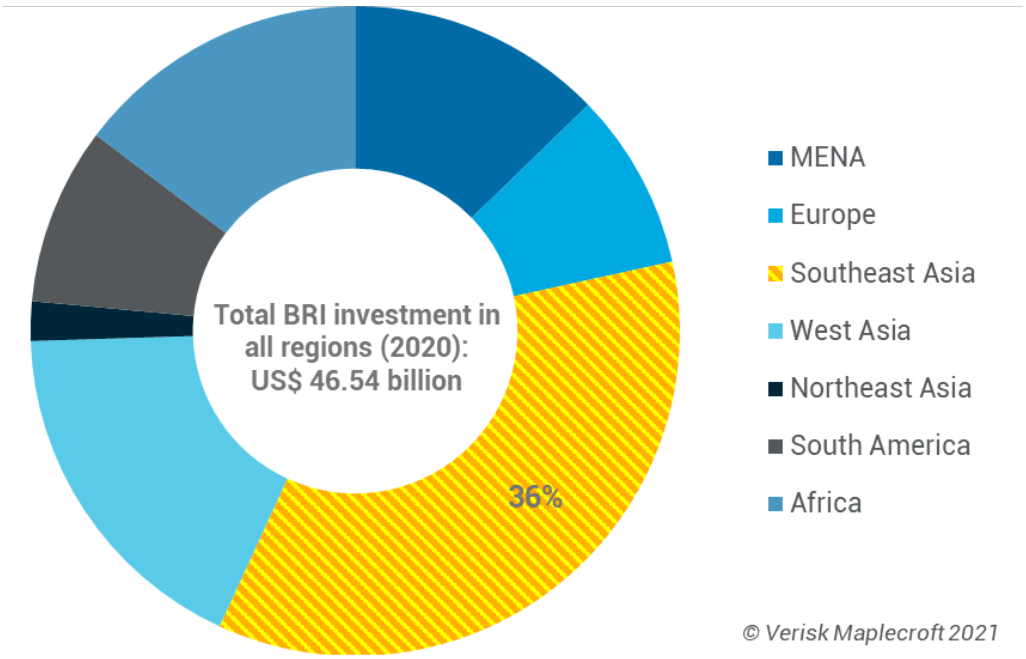
Chart 3: BRI investment distribution in 2020



Source: AEI 2021

Investment data show that, similar to trade patterns, the Southeast Asian market has become more important to BRI investment,[9] especially since the pandemic. China has diverted its investment initiatives to Southeast Asia as a result of COVID disruptions in the West, and growing geopolitical tensions. Both China and ASEAN member states have encountered severe business disruption across all sectors, and are desperate to resume business activities to mitigate the economic impact of COVID-19. While Southeast Asia appears to be a more friendly market destination for China under the current geopolitical environment, China likewise, through its early industrial resumption, has emerged as a strong economic partner during the pandemic. Therefore, both ASEAN and China have emphasised China-ASEAN economic cooperation as a means to spur their economic recovery.

A large part of BRI investment in Southeast Asia focuses on building supply chain infrastructure, such as Power Construction Corporation's gas-fired power plants in Myanmar[10] and Zhejiang Huayou's nickel and cobalt projects in Indonesia.[11] With these projects, China may export any excess capacity overseas and import any necessary resources for its industrial base. Energy and resource cooperation is closely linked throughout the BRI, given the potential for large-scale energy projects to bring about infrastructure opportunities and industrial access.

RISKS ASSOCIATED WITH MEGAPROJECTS: A CASE STUDY OF THE CHINA–MYANMAR ECONOMIC CORRIDOR

China has been ambitious in expanding its BRI footprint in Southeast Asia, even during the COVID pandemic. This ambition is exemplified by the China-Myanmar Economic Corridor (CMEC). China and Myanmar first signed the CMEC agreement as part of the BRI in 2017. This agreement encompasses a number of infrastructure projects that strategically connect the oil trade from the Indian Ocean to China's Yunnan province via Myanmar. Key infrastructure

investments in the CMEC include a deep-water port, several large-scale energy and transport projects, and the Kyaukphyu Special Economic Zone (SEZ).

After securing the CMEC agreement in 2017, both parties have been engaged in negotiations over the implementation of the abovementioned megaprojects. However, there has been limited progress due to concerns over the projects' commercial viability. In 2020, which marked the 70th anniversary of China-Myanmar diplomatic relations, both sides signed another 33 bilateral agreements during Chinese President Xi Jinping's state visit to Myanmar in January to facilitate the implementation of the CMEC. In particular, these agreements cover the development of a deep seaport at the Kyaukphyu SEZ, the Muse-Mandalay electric railway and the New Yangon City project.

In spite of the business disruption brought about by the COVID crisis, China has continued to urge the Myanmar government, via presidential calls and high-ranking official visits, to speed up the implementation of planned CMEC projects.[12] China has sent a strong political signal that it is still keen to push the CMEC forward.

The 2021 Myanmar coup has further complicated the business environment in the country, placing Chinese projects directly at risk and threatens Beijing's economic interests in the country. The civil unrest, anti-China sentiments and Myanmar's attempt to reduce China's influence have dragged Chinese projects into the centre of the domestic political dispute. A number of Chinese business in Myanmar are reportedly suspended and pulling out non-essential staff.[13] It also remains unclear if the military government will honour or re-negotiate the Chinese projects and agreements previously approved by Suu Kyi's administration. However, once the political turmoil settles down, China will likely resume efforts to integrate Myanmar into its economic orbit. The current political uncertainty will certainly lead to business disruption, but Myanmar will likely remain a long-term destination for Chinese investment, particularly in the energy, mining and infrastructure sectors.

In general, Beijing expects BRI investment in Myanmar to contribute to energy security, market creation and stability in its 'neighbourhood'. Beijing maintains that an economic slowdown in its 'neighbourhood' would result in social instability and security threats, which could in turn threaten the political stability of Chinese border provinces such as Yunnan. However, from a Myanmar perspective, other than the above political risks, there are longer-term uncertainties about the commercial viability and ESG risks of the proposed megaprojects.

Kyaukphyu SEZ deep seaport: The SEZ seaport has been the coastal energy terminus of the China-Myanmar oil and gas pipelines running into China's Yunnan province since 2013. Its development is in line with Beijing's long-term energy security goal of gaining access to the Indian Ocean via Myanmar and reducing reliance on the Strait of Malacca for oil and gas imports. However, since the China-Myanmar oil and gas pipelines have a limited capacity of approximately 160 million barrels of oil and 12 billion cubic metres of gas per year, it is considered merely as a contingency plan.

Besides, the lack of energy policy reform in Myanmar has also created uncertainty for the profitability of Chinese oil and gas projects in the country. The fiscal terms of Myanmar's current production sharing contract model were introduced when oil prices were high, and these terms are no longer favourable to investors in a low-oil-price environment. More industry incentives are needed for investors to commit to energy projects in costly and risky deep waters.

The Myanmar government is currently attempting to reform its oil and gas regime to attract investment, and a successful renegotiation of Woodside's fiscal terms in late 2019 represented an early positive signal.[14] However, the proposed reform of the tax-heavy fiscal framework in 2020 and the opaque production sharing contract model in the current oil and gas law remains noncomprehensive and hinders further foreign investment. Under the current political circumstances, it will be difficult for Myanmar to carry out energy reform or to revise its fiscal terms to attract upstream investors.

Muse-Mandalay electric railway: The railway is a megaproject under the CMEC, designed to facilitate the transport of goods between China's Yunnan province and Myanmar's Kyaukphyu SEZ. Since the signing of the CMEC agreement in 2017, China and Myanmar have been engaged in negotiations over the terms of the Muse-Mandalay electric railway. Concerns over the megaproject's commercial viability, however, remains a key obstacle. The proposed railway passes through highly volatile areas in Northern Shan State in Myanmar. Hence, any implementation of the project will face security and social risks unless the conflict in the area is resolved beforehand.

In June 2020, Myanmar Railways said that the government was receiving help from a third-party consultancy firm to scrutinise the Muse-Mandalay electric railway feasibility study. By seeking third-party review, the Myanmar government is demonstrating that it does not necessarily have to push ahead with Chinese megaprojects without properly assessing the social and security risks that could undermine the project's commercial viability.

New Yangon City project: The New Yangon City project aims to build a brand new smart city for a population of 1.2 million people in southern Myanmar by 2050. As part of the CMEC, the US$1.5 billion project was proposed by China Communication Construction Company (CCCC) in 2018. During Xi's state visit in January 2020, both sides inked a letter of intent on the development of the megacity project.

In September 2020, the Myanmar government hired a third-party German consultancy firm to step up scrutiny of the project. This included carrying out a 'Swiss challenge' tendering process, which would have brought other international firms into the megacity project to challenge CCCC's bid. The Chinese developer was recently blacklisted by the United States for its operations in the South China Sea and previously sanctioned by the World Bank from 2011 to 2017 for fraud. This stricter scrutiny of Chinese investment thus demonstrates Myanmar's desire to mitigate the risks associated with the megaproject, avoid having one single company dominate the project, and prevent itself from incurring unsustainable debt obligations. Moreover, any new sanctions would make it harder for responsible companies adhering to international best practice to keep operating in Myanmar due to reputational and ESG consideration.

IMPLICATIONS FOR ECONOMIC RECOVERY AND GEOPOLITICS

While the BRI appears to be an economic panacea for COVID-19, the Myanmar case demonstrates that potential ESG risks associated with unsustainable megaprojects could be a long-term concern. While key decisions on megaprojects are typically made on the basis of national priorities, costs and benefits are asymmetric among countries in the BRI.[15] Although it is claimed that BRI projects are based on the common good (or what has been commonly described as "building a community of shared interests") and have net socio-economic benefits,

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these projects could be favourable from the BRI's perspective but not from an individual country's perspective. In some cases, an infrastructure investment project could be favourable from a particular country's perspective but might only achieve limited socio-economic benefits beyond that country's borders.

A 2015 report from the Brookings Institute pointed out that Chinese investments are equally distributed between good and poor ESG regions, whereas Western investments usually avoid the latter.[16] Although Chinese investors target countries which Western countries find difficult to invest in, these investors may not always be capable of handling such projects. There will be a surge in FDI in the early stage of such BRI investments, but the deficit will worsen over the long run if such projects lack sustainability. Considering the divergences in ESG and security risks, BRI projects in ASEAN that involve cross-border or multinational issues could be exposed to delays or disputes. Although the completion of BRI projects will plug investment gaps in Southeast Asia, unsustainable ones will impose extra burdens on economic recovery. From this perspective, smaller infrastructure projects will likely have higher commercial viability than megaprojects, thus contributing more to spur economic recovery in Southeast Asia.

There are international debates about whether the BRI will play a complementary role alongside Western investment in Southeast Asia or replace the existing economic institutions.[17] It is unavoidable that BRI investments will compete with existing ones by taking up market share. The BRI has also brought its combined commercial strategies and developmental policies to Southeast Asia. Chinese financing terms – such as low interest rates, flexible requirements and syndicated loans – are more attractive than those of Western investors and competitors. If Chinese lenders offer more competitive and permissive loans than those offered by the existing multilateral lending system, then developing countries that wish to avoid the restrictions of Western lenders may turn to China. Over time, increasing investment under the BRI has the potential to increase the Southeast Asian economic reliance on China and reshape the existing alliance pattern in the region.

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[1] ADB (2017) 'Meeting Asia's infrastructure needs'. Available at: https://www.adb.org/publications/asia-infrastructure-needs.
[2] Oil and gas, renewables, power, etc.
[3] AIIB (2017b) 'Energy sector strategy: sustainable energy for Asia', Asian Infrastructure Investment Bank
[4] Energy investment not only includes resource trade but always involves huge levels of spending on different forms of infrastructure such as pipelines, grids, solar panels, power plants and refineries, as well as ports and roads connecting remote fields.
[5] Dollar, D. (2020) China and the West competing over infrastructure in Southeast Asia, Brookings Institute.
[6] Hornby, L. (2016) 'China seeks foreign investors for One Belt, One Road push', Financial Times, 25 May; Pavlićević, D. (2015) 'China, the EU and One Belt, One Road strategy', China Brief, 15: 15. Available at:

http://www.jamestown.org/programs/chinabrief/single/?tx_ttnews%5Btt_news%5D=44235&cHash=9dbc08472c19ecd691307c4c1905eb0c#.V9-58CTuCXs (Accessed 18 January 2018).
[7] Here, 'BRI investments' refers to a combination of investments and construction contracts.
[8] Oil and gas, renewables, power, etc.
[9] Here, 'BRI investments' refers to a combination of investments and construction contracts.
[10] This project is a 135MW gas to power plant by Sinohydro (a brand of Power Construction Corporation of China) and Supreme Trading. The investment size is US$180 million. It was approved by the Myanmar government in January 2018.
[11] This project is a nickel and cobalt processing plant in the Morowali Industrial Park by Zhejiang Huayou , China's top cobalt maker. The investment size is US$1,240 million. Construction and development work on the project was scheduled for 2020 but has experienced delay due to the pandemic.
[12] For example, in late May 2020, Myanmar President U Win Myint and Chinese President Xi Jinping arranged a phone conversation to discuss coordination during COVID-19. During the call, Xi expressed hope that Myanmar would speed up the implementation of infrastructure projects in the China-Myanmar Economic Corridor (CMEC) first agreed to in 2017. Similarly, on 2 September 2020, Yang Jiechi, a Politburo member and director of the Central Foreign Affairs Commission of China, visited Myanmar and urged the start of delayed Belt and Road Initiative projects before the national election, despite the steady rise of anti-Chinese sentiment in the country.
[13] Zheng, W. (2021) 'China tells state firms in Myanmar to evacuate non-essential staff'. South China Morning Post, 16 March.
[14] According to Woodside's local partner, the Myanmar government offered more favourable fiscal terms to Woodside in its production sharing contracts.
[15] Parameswaran, P. (2017) 'The real trouble with China's Belt and Road'. The Diplomat, 11 May. Available at: https://thediplomat.com/2017/05/the-real-trouble-with-chinas-belt-and-road/ (Accessed 1 January 2018).
[16] Chen, W., Dollar, D., and Tang, H. (2015) 'Why is China investing in Africa? Evidence from the firm level'. Report, Brookings Institute.
[17] Dollar, D. (2016) 'China as a global investor'. Working paper 4, Brookings Institute; Legault, G.-F. (2015) 'AIIB melding, not moulding global governance'. East Asia Forum. Available at: http://www.eastasiaforum.org/2015/11/18/aiib-melding-not-moulding-global-governance/ (Accessed 1 January 2018).

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