Beyond the "Debt Trap": China's Infrastructure Investment in Southeast Asia

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Abstract. In the dynamic landscape of Southeast Asia, the waning influence of the United States contrasts sharply with China's burgeoning economic presence. The ambitious Belt and Road initiative has invested substantial infrastructure aid into the region, causing debates over the governance capabilities of the beneficiary states. The Lao's Boten–Vientiane Railway and Malaysia's East Coast Rail Link often cited for exacerbating fiscal liabilities and fostering corruption risks. This study focuses on the relation between China's infrastructural investment and government performance within Southeast Asian nations. By analyzing these projects, it offers a novel rebuttal to common criticisms. Despite the tortuous journey of these grand infrastructural projects led by China in Southeast Asia, they have brought about significant enhancement in economic and governance capacity in the host countries.

Keywords: infrastructure, Belt and Road, China, Southeast Asia

1 Southeast Asia and China's Infrastructure Investment

Since the launch of the Belt and Road strategy in 2013, China has built a number of large-scale infrastructure projects in Southeast Asia, with some of the "star projects" being regular features in the Chinese media, such as the Jakarta-Bandung high-speed railroad and the yet-to-be-completed Kra Canal in Thailand. The influx of Chinese aid has subtly altered the geopolitical landscape of Southeast Asia: it is often provided in the form of infrastructure projects with no political strings attached, but there are also criticisms that China has never followed OECD aid standards or examined the political and economic conditions of recipient countries. This represents a potential for China to target funds to more corrupt and authoritarian countries [1], thereby expanding its influence and even "undermining the efforts of other aid donors to promote good governance, democracy and human rights in developing countries [2]."

Other scholars, like Roy-Chaudhury, have expressed concern about the debt problems of Southeast Asian countries, such as the Hambantota Port in Sri Lanka, which has been blamed for exacerbating Sri Lanka's debt crisis. In order to successfully complete the project, the Sri Lankan government borrowed a large

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amount of loans from China, but the commercial activities of the port did not live up to expectations and the operation had to be handed over to China. He attributed the failure of these projects to China, arguing that it is China's infrastructure assistance that has led to a decline in the level of governance and a crisis in the democratization process in the recipient countries [3]. Others have even argued that China's activities in Southeast Asia will lead to a worldwide resurgence of authoritarianism [4], and that China's blindness to corruption and authority undermines the West's efforts to promote democracy [5].

The Curse of Aid, which grew out of the Curse of Natural Resources, has gained attention in recent years. Both theories emphasize that external revenues, whether from the sale of natural resources or from foreign aid, can have a negative impact on a country's economy and politics. Using data from 108 recipient countries from 1960 to 1999, Djankov and his and his research team have found that if a country receives foreign aid as a percentage of GDP at the 75th percentile in the sample over a five-year period, the country's Democracy Index falls by 0.5 to 1 point and government rent-seeking and corrupt behavior grows dramatically [6]. This is why the port of Hambantota has become a typical example of China's much criticized foreign aid.

Bader has refuted these arguments. He argued that China is not the creator of a "debt trap" but merely a profit-driven opportunist whose foreign policy does not pose a significant threat to the global democratization process [7]. Other scholars, like Svensson, argue that it is not China that is responsible for the spread of corruption: in countries with more acute domestic political tensions, larger "windfalls" from any state can lead to serious corruption [8]. Li and his research team have used data on China's foreign aid and the Uppsala conflict from 2000-2014 and found that China's "other official assistance" significantly reduces the probability and scale of conflict in recipient countries. They find that the effectiveness of China's aid derives mainly from its contribution to infrastructure and industrial employment in the recipient countries, as well as its contribution to political stability and popular support in the recipient countries [9].

As can be seen from the above, the infusion of Chinese financial assistance into Southeast Asia has sparked considerable debate, particularly as the region grapples with significant challenges to the efficacy of its governance structures. Recent assessments suggest a decline in governance quality across Southeast Asia over the past decade, marked by acute human rights issues, escalating military confrontations, and persistent political volatility. Against this backdrop, this paper probes the potential impact of substantial Chinese aid on the governance capabilities within these nations. It scrutinizes two contentious initiatives within China’s Belt and Road initiative—the Boten–Vientiane Railway in Laos and the East Coast Rail Link (ECRL) in Malaysia—evaluating their inception, evolution, and culmination through the lens of development and governance. In dissecting the trajectory of these projects, the study endeavors to furnish a cogent analysis addressing the aforementioned concerns related to above.

2 Case Study: The Boten–Vientiane Railway

Lao PDR, the sole landlocked nation within Southeast Asia, lacks maritime access, which has historically hindered the development of its transportation infrastructure. The nation's rugged topography has necessitated a reliance on road transport, which accounts for approximately 80% of both passenger and cargo movement. Waterborne transport, while less prevalent, constitutes 18% of the overall transport volume [10]. As of 2015, Laos's railway infrastructure was limited to a scant 3.5-kilometer track extending from Thanaleng Station in Vientiane to the Thai border at the First Thai–Lao Friendship Bridge—a project realized through a 197 million baht investment from Thailand.

Confronting infrastructural and human resource deficiencies, the Lao government enacted the Law on the promotion and management of foreign investment (1994), thereby endorsing trade liberalization [11]. The United Nations Conference on Trade and Development (UNCTAD) reports that foreign direct investment in Laos surged from a modest 2 million dollars in 1988 to an impressive 900 million dollars by 2019 [12]. While this law has undeniably spurred economic expansion, it has also introduced significant challenges. Predominantly, foreign capital has been funneled into the hydropower and mining sectors, leading to an overreliance on natural resource exploitation. This dependency often precipitates a contraction in agricultural and industrial sectors, a phenomenon akin to the 'Dutch Disease.' This economic condition is characterized by increasing national debt—surpassing 76% of GDP between 2011 and 2013—escalating income disparity, and persistent high corruption indices [13]. Despite two decades since the Law on the Promotion of Foreign Investment's implementation, Laos's infrastructural landscape remains largely unchanged. Burdened by fiscal and trade deficits, the government has been compelled to curtail investments in social welfare and public works.

Amidst an escalating debt crisis, the nascent Boten–Vientiane railway project has been scrutinized for potentially exacerbating the debt load of host nations [14]. As Laos' most significant infrastructure endeavor currently underway, the Boten–Vientiane railway presents a myriad of challenges for the Lao government. Initially, it was evident that the government lacked sufficient management capabilities: local construction workers were deficient in fundamental skills, and there was an inability to procure quality construction materials domestically. Financially, the project teetered on the brink of collapse, with compensation for displaced residents along the proposed route unattainable. The crux of these issues lies in the absence of regulatory technology and managerial expertise. Prior to the railway's inception, Laos possessed rudimentary railway legislation and scant experience in rail transport coordination, coupled with one of the world's highest vehicular accident rates.

But as the project progressed, Laos learned to manage such large-scale projects from scratch in its cooperation with China. Since Carl Deutsch first proposed policy learning in 1966 [15], the theory has undergone several developments and refinements. Based on Deutsch's work, Peter J. May studied how "political learning" leads to changes in government behavior and how these changes affect social policies

[16]. The process of building the Boten–Vientiane railway was also a process of learning for the Lao government. As a country with an extremely well-developed railroad system, China's Kunming Railway Bureau alone has 393 specialized technical regulations. On the basis of its own railroad technical management experience, China has formulated a brand new set of transport management rules and regulations within the scope of the concession agreement by localizing them with Lao laws and regulations, management requirements and characteristics of facilities and equipment, and set up 28 items and 41 professional and technical rules and regulations in accordance with 4 management modules, namely, transport organization, mobile equipment, stationary equipment, safety and emergency response [17]. In addition, in response to the shortage of skilled workers and lack of professional training means in Laos, China has compiled training manuals such as "Handbook of Han-Lao Railway Terminology" and "Regulations on Technical Management of the Mouvane Railway" to meet the needs of practical training for Lao employees.

In order to ensure subsequent operations, the Lao government must learn all aspects of managing these large-scale projects, including project progress management, budget management, personnel scheduling, and operation and maintenance after completion. Political learning is a dynamic process that involves communication and consultation among policymakers, as well as reflection on and evaluation of past experiences, and this learning process helps governments better adapt to complex environments and develop effective solutions. April 30, 2019, three years after the project began, Laos finally has a better copy of the Railway Law. The law sets out the steps developers must fulfill, including conducting feasibility studies, surveys, developing plans, and rehabilitation and maintenance plans. The law also sets out principles and regulations for the management of railroad services, including passenger and freight transportation and logistics services. Under article 41, compensation for property occupied by railroad projects must be paid before the land is handed over to the developer, and the compensation process must be conducted in a fair and transparent manner [18].

3 Case Study: The Malaysia East Coast Railway Link

Another typical Chinese project in Southeast Asia is the East Coast Railway Link (ECRL) in Malaysia. In early 2015, the Land Public Transport Commission of Malaysia proposed a plan to build the East Coast Railway, and China Communications Construction Group Corporation Limited (CCCC) was successful in bidding for and undertaking the project. The East Coast Railway (ECRL), with a total length of approximately 688 kilometers, is planned to connect Kuala Lumpur and the East Coast Economic Region. The initial estimated construction cost is RM55 billion, with financing primarily provided by Chinese government funding and a loan from the Export-Import Bank of China.

On August 9, 2017, Malaysian Prime Minister Najib and Chinese State Councilor Wang Yong were in attendance at the opening ceremony of the East Coast Railway in

Kuantan [19]. During the year, the two countries entered into a memorandum of understanding on the Belt and Road Initiative, thereby establishing a comprehensive cooperative partnership. The relationship between the two countries has undergone a significant transformation in a relatively short period of time.

The relationship between China and Malaysia was experiencing a period of growth and prosperity when a political crisis emerged. In 2015, Najib became embroiled in allegations of graft and corruption. The Sarawak Report and the Wall Street Journal have accused him of channeling over RM2.67 billion from 1MDB into his personal accounts [20]. 1MDB is a quasi-sovereign wealth fund under the Malaysian Ministry of Finance, also known as One Malaysia Development Berhad. Media investigations revealed that the organization's debts had reached a staggering RM42.1 billion. These revelations marked the beginning of the end of Najib's political career. In 2018, UMNO, which had governed for 61 years, conceded defeat in the general election, paving the way for Mahathir Mohamad to become the new prime minister. Subsequently, the incoming government discovered that the actual costs of the East Coast Railway project, including land acquisition and loan interest, could reach RM81 billion, which is RM26 billion above the initial projections. On July 3 of that year, the Malaysian Ministry of Finance announced the dissolution of the Land Transport Commission and the suspension of the ECRL project. In addition, the construction of two pipelines, each with an estimated cost exceeding one billion US dollars, was also suspended. These pipelines were both constructed by China.

The rationale behind the abrupt termination of the ECRL project may not be a "corruption scandal" as posited by the media, but rather more closely aligned with the shift in political leadership in Malaysia. Following his electoral victory, Mahathir articulated his intention to the electorate, stating, "We are seeking to restore the rule of law [21]." In order to dispel public skepticism about his ability to govern effectively, Mahathir had to implement significant reforms to demonstrate his credibility. One of the "ten promises in the first 100 days" released during his election campaign was to
"Initiate a comprehensive review of all mega projects that have been awarded to foreign countries [22]." This promise was evidently directed at the Najib government, but since the ECRL and gas pipeline projects were initiated during Najib's tenure, they served as convenient scapegoats. After 100 days in power, the new government conducted a review of its 46 achievements, including the "delayed construction of the gas pipeline" and the "cancellation of the East Coast Rail Link."

In a 2019 interview, Prime Minister Mahathir Mohamad addressed the 1MDB scandal, stating," but [documents] must be in our hands before we can accept the statement made. Until then we cannot take action. " This position implies a lack of evidence implicating China's involvement in the affair [23].

During the 1MDB debacle, media coverage appeared disproportionately focused on the alleged involvement of China, often overshadowing the role of the American investment bank, Goldman Sachs. According to a statement by the U.S. Department of Justice, Goldman Sachs conceded to engaging in the payment of over one billion U.S. dollars in bribes to Malaysian officials during the bond underwriting process for 1MDB, with the objective of securing and maintaining its business interests [24].

Consequently, former executive Tim Leissner received a lifetime ban from the securities industry. In response to these allegations, Goldman Sachs consented to a settlement involving approximately $2.9 billion in penalties to various regulatory bodies, inclusive of a fine nearing $1.3 billion to the U.S. Department of Justice—the most substantial penalty to date under the U.S. Foreign Corrupt Practices Act.

4 Conclusions

Since the Belt and Road Initiative start, China's infrastructure investment in Southeast Asia has seen unprecedented growth, and its growing influence at the regional level has raised concerns among countries. As China's number one competitor in the Asia-Pacific region, the United States has maintained a vigilant attitude. U.S. Vice President Mike Pence in a major speech on China's policy, said China to the recipient countries to provide most of the loans are extremely opaque, which is the use of "debt diplomacy" to expand its sphere of influence. But the recipient countries don't necessarily have a favorable opinion of China either - statistics show that people in Southeast Asia have more negative opinion of China year after year [25].

For China itself, infrastructure investment has never been pleasant. Despite a strong bureaucracy and a strong economy, China has experienced twists and turns and repeated setbacks in its cooperation with Southeast Asian countries, with the aforementioned ECRL railroad being a typical case in point.

There are two main reasons for this: first, every stakeholder in a large-scale project may bring potential conflicts. The political, economic, and cultural differences between the various countries in Southeast Asia are enormous, and the complex bureaucracy and numerous interest groups add to the obstacles to the advancement of the project. Jeffrey Pressman and Aaron Wildavsky refer to the "complexity of joint action" in their writings, and China's large-scale infrastructure projects in Southeast Asia are typical examples [26]. China's large-scale infrastructure projects in Southeast Asia are typical of projects involving many stakeholders, each of which has its own internal rules, goals, and interests. With each additional "audit point" (or stakeholder), the chances of the project encountering obstacles increase exponentially during the course of the project. In a project with 70 audit points, each of which has a 99% chance of passing successfully, the probability of a major conflict has reached more than 50% by the 69th audit point.

Second, frequent regime changes in recipient countries are also a serious problem. When Thailand was chairing ASEAN, the Abhisit government offered to cooperate with China to build a high-speed rail line through Laos to the Thai-Malaysian border. However, the Abhisit government lost power in the 2011 election, and although the subsequent Yingluck government was also interested, the project was suspended for a while. after the 2014 coup, Thailand's current military government took power. The junta's willingness to cooperate was not high, and the project was suspended indefinitely after negotiations reached a dilemma. This kind of situation has long been common in "Belt and Road" cooperation, and a series of problems often arise after a change of regime in a recipient country, including disruption of the approval process, loss of policy continuity, and replacement of project leaders. The new government always puts short-term political interests ahead of long-term development goals, making cooperation difficult to sustain.

Looking at infrastructure investments, they often face greater conflicts and risks, and there is no guarantee of profitability. Even if there is a possibility of cost recovery, it usually takes a decade or more. Starting in the 1990s, the World Bank began to apply more rigorous standards when assessing infrastructure loan applicants. Francis Fukuyama contends that by 2010, the World Bank, which was the largest global lender at the time, had largely ceased its involvement in financing infrastructure projects [27].

Until now, China has remained the sole provider of infrastructure investment to many developing countries, especially in less developed Southeast Asia. Most of the recipient countries have enjoyed the development opportunities brought about by infrastructure upgrading: the resumption of negotiations for the ECRL railroad in Malaysia directly created 18,000 local jobs. The construction cost per kilometer of railroad, on the other hand, has dropped from about CNY154 million previously to about CNY111 million, directly earning the country a 32.8 percent discount [28]. If the project is profitable, Malaysia will receive up to 80 percent of the profits, according to the Malay Mail [29]. The opening of the Boten–Vientiane railway has transformed Laos from "land-locked" to "land-linked", promoting the sale of agricultural products and the free flow of people, and attracting major domestic and foreign enterprises to set up development zones along the route [30]. The Lao Government has strengthened its debt management by finalizing and adopting the Law on Public Debt Management, and its economic development in the past five years has maintained high growth, low inflation and stable exchange rate.

Since the launch of the Belt and Road Initiative in 2013, Japan proposed the Partnership for Quality Infrastructure Investment in 2015, Australia proposed the Pacific Infrastructure Finance Facility in 2019. The United Kingdom, the United States, and the European Union have also set new infrastructure investment targets. There are concerns that this could become a "zero-sum game", with developing countries having to choose sides between China and the West. However, the existence of multiple options could provide these countries with more diversified programs and better conditions for financing and development. China and other countries could also complement each other's strengths, cooperate in the provision of public goods and establish new partnerships in the international development arena.

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