

# Laos And The Silk Road Economic Belt – Analysis

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In his April 2014 meeting with the visiting Laotian Prime Minister Thongsing Thammavong, Chinese President Xi Jinping highlighted the need for China and Laos to intensify their comprehensive strategic partnership to achieve their national development goals. In particular, President Xi noted that Sino-Lao cooperation should focus on strategic industries like energy and resource extraction, green tourism, and infrastructure construction. In return, Prime Minister Thammavong confirmed Laos' commitment to participating in China's "Belt and Road" megaprojects.<sup>1</sup>

Laos' key national development goal is to bring its population out of poverty, and in so doing, graduate from the United Nations' group of Least Developed Countries (LDCs). Even though Laos currently enjoys GDP growth of almost 7%, this growth is in low-employment sectors like hydropower. The Laotian government hence aims to achieve poverty alleviation through employment generated by industrialization, and the government recognizes that the modernization of the country's infrastructure will be instrumental to the success of the industrialization effort. With 90,000 Laotians entering the job market each year, the industrialization and modernization efforts are critical. The Laotian government hence welcomes China's "Belt and Road" infrastructure megaprojects, which are expected to help Laos fulfill these tasks.<sup>2</sup>

## The Opening of Laos

China's "Belt and Road" transportation and energy infrastructure megaprojects in Laos will build on earlier transportation and energy infrastructure projects initiated by the Asian Development Bank (ADB) in the 1990s under its Greater Mekong Subregion (GMS) program, which sought to transform the economies of the Mekong nations (Cambodia, Laos, Myanmar, Thailand, and Vietnam) and the southern Chinese provinces of Guangxi and Yunnan into an integrated market. Indeed, China's "Belt and Road" megaprojects in Laos should be recognized as being built on the foundation of the ADB's earlier Laotian projects. As the ADB is an international financial institution (IFI) that is under US and Japanese control, China's current economic influence in Laos and the region has, as we shall see, raised Japanese anxieties over what they perceive to be the loss of their influence.<sup>3</sup>

A good example is the ADB's work with the GMS region is the North-South Economic Corridor (NSEC) project that connects Yunnan with Thailand through Laos. The NSEC has facilitated a boom in trade between China and the GMS economies, with Laos functioning as the key transshipment node. This boom in trade has been accompanied with an increased Chinese economic presence in Laos, which is expected to intensify following new Chinese investments under the "Belt and Road" framework. In historical perspective, China's economic relations with Laos date from the precolonial Lao kingdom of Lan Xang, which gained wealth from exchange with the Chinese Muslim caravan trade. The current migration and settlement of Chinese entrepreneurs and traders in Laos following the establishment of the NSEC echoes the migration of Chinese settlers into Laos during the subsequent French colonial period.<sup>4</sup>

Laos had joined the ADB's GMS initiative over two decades ago in 1992, following the Laotian government's implementation of the New Economic Mechanism (NEM) in 1986, through which Laos began its transition from a socialist planned economy to a capitalist market economy. Under the NEM,

Laos not only joined the GMS, but also ASEAN (1997) and the WTO (2013); this gradual opening of the Laotian economy to foreign trade and investment contributed to its two decades of annual GDP growth of 6.7%—including 7.6-7.8% growth during the global financial crisis years of 2009-2010—and an increase in per capita GDP from 329 to 1069 USD between 2001 and 2010. Laos' strategic asset is its geographical position as a land bridge between China and the mainland Southeast Asian states of Myanmar, Thailand, Cambodia, and Vietnam. This has been deployed in the GMS' NSEC project as well as the East-West Economic Corridor (EWEC) project which connects Myanmar and Thailand with Vietnam through Laos. Laos' involvement with China's planned Southeast Asian rail network can be viewed as an extension of the Laotian government's strategic drive to transform Laos from a land-locked to a "land-linked" country. However, the current state of Laos' transportation infrastructure remains poor, and big improvements are necessary before the country can fully leverage its geographical location to become the logistics hub for the region.<sup>5</sup>

## **The Pan-Asian Railway**

China sees the Mekong nations—Myanmar, Laos, Thailand, Cambodia, and Vietnam—as key to the success of the "Belt and Road." Economically, this region offers tremendous potential for growth, as these nations represent a market of over 320 million people, and whose regional trade with China amounted to over 150 billion USD in 2013. These nations will be involved in the proposed Pan-Asian Railway that is one of the key Silk Road Economic Belt infrastructure megaprojects. This railway will connect the southern Chinese city of Kunming with Singapore. From Singapore the railway will travel up the Malay Peninsula through Malaysia and into Thailand. At Bangkok the railway will split into three lines that will separately terminate at Kunming. One line will go through Laos; another through Myanmar; and the third through Cambodia and Vietnam. Laos regards its section of the Pan-Asian Railway as key to its development, and has flagged the construction project as a major priority in the nation's 8th Five Year Plan.<sup>6</sup>

This rail connection between Kunming and Vientiane will be an infrastructure megaproject in its own right. The Laotian portion of Kunming-Vientiane line is a high-speed rail line that will involve the construction of 154 bridges, 76 tunnels, and 31 train stations. The project will cost an estimated 7 billion USD, which will be paid for by the Laotian government with concessionary loans from China, with Laos' mineral wealth as collateral. Experts from the ADB and the World Bank feel that this will put Laos at an unreasonable level of debt, as the loans will amount to almost 90% of the country's annual GDP, transforming Laos into one of the world's most indebted countries. While the Laotian government sees this debt burden as a short-term sacrifice that will benefit the country in the long run, Laos' growing indebtedness puts it at high risk of a Greek-style external debt crisis.<sup>7</sup>

To facilitate the implementation of China's projects in Laos, various financial instruments have been established, including a Sino-Lao joint venture between Yunnan's Fudian Bank and Laos' Foreign Trade Bank. China's Asian Infrastructure Investment Bank (AIIB), of which Laos is a founding member, is expected to offer additional lines of financing for "Belt and Road" projects once it starts operations at the end of 2015. In the case of the Kunming-Vientiane high-speed rail line, the Laotian and Chinese governments have set up a joint company which will implement the megaproject. China Railway Group has expressed confidence that it will win the construction contract given the heavy Chinese financing.<sup>8</sup>

## **"Turning Land into Capital"**

Laos' strategic geographical position has made it one of the key destinations for Chinese foreign direct investment (FDI). China was Laos' top investor in 2014, with over 5 billion USD invested in the country. China has also become Laos' largest export market, and Sino-Lao bilateral trade reached 3.6 billion USD in 2014, a 32% increase from the previous year. This is poised to increase with the involvement of Laos in the "Belt and Road." The Chinese conglomerate CITIC, for example, will invest over 700 billion RMB in China's "Belt and Road" projects, including projects in Laos. Chinese FDI in sectors like agriculture, hydropower, mining, timber, and tourism (including casinos) fits with the Laotian

government's development strategy dating from the 1990s of "turning land into capital," through which land is monetized through leases and resource extraction. The arrival of Chinese investment and know-how was welcomed by the Laotian government as the economy was expected to benefit not just from the increased revenue but also from the human capital development that would come from the transfer of knowledge and skills from Chinese experts, especially with regard to the best methods for the optimal exploitation of Laos' natural resources. The rubber boom of the 2000s offers a good example of Sino-Lao cooperation, as these joint ventures between Lao state firms and Chinese enterprises replaced indigenous opium fields with commercial rubber plantations. Not only did the Laotian economy benefit from the revenue from the cash crop, the local labour force enjoyed regular wages and increased their agricultural expertise.<sup>9</sup>

China is also one of Laos' top donors of overseas development aid (ODA). Chinese ODA generally consists of grants and low- or no-interest loans. Approximately half of China's ODA to Laos is spent on the development of transportation infrastructure, for example the 33 million USD construction of the 70 km section of Road 3 which runs from Luang Namtha and Borkeo provinces to the Chinese border. A recent study of the socio-economic impact of China's Road 3 project confirms the beneficial effect of poverty alleviation arising from increased trade and investment leading to employment and income generation opportunities for the local population. Mirroring the pattern of Sino-Cambodian relations, the increased economic assistance provided by China to Laos will be matched with military assistance and security cooperation.<sup>10</sup>

In the energy sector, Laos is estimated to have the potential to generate 26,500 MW of hydropower, of which 18,000 MW is technically exploitable. To unlock this hydropower potential and transform Laos into the "battery of Southeast Asia," the Laotian government has ambitious plans to build 70 dams along the tributaries of the Mekong River. Many of these are being or will be constructed by Chinese hydropower firms. Laos is already exporting electricity generated from its hydropower dams to Thailand, and the revenue generated from hydropower could go far to help Laos achieve its goal of leaving the ranks of the world's LDCs. At present, Laos is moving ahead with the construction of the controversial Don Sahong hydropower dam. While the developer is Malaysia's Mega First Corporation, Mega First is negotiating with China's Sinohydro Corporation over the construction. Not only have experts warned that Don Sahong could drive the endangered Irrawaddy dolphin into extinction, the potential threat the dam poses to downstream fisheries could trigger a diplomatic crisis with Cambodia, Thailand, and Vietnam.<sup>11</sup>

## **The Reassertion of Japanese Influence**

The increased Chinese economic presence in Laos and the Mekong nations has triggered concerns among the Japanese of the perceived threat to their traditional influence in the region. This has prompted the Japanese government to offer an additional 6.17 billion USD in ODA to the five Mekong nations. The Japanese government had earlier infused the ADB with an additional 110 billion USD in funds, in response to the coming challenge posed by China's AIIB. The Japanese government has sought to differentiate ADB-funded projects from the AIIB's with the rhetoric of "quality," even though there is no evidence that the AIIB, which has yet to select its projects, will ignore quality in its selection process. As the receipt of ODA and FDI is not a zero-sum game, the likely result of this competition between China and Japan will be a welcome increase in funding options for Laos and the other beneficiary nations. As Indonesian Finance Minister Bambang Brodjonegoro has pointed out, Asia's infrastructure needs are too great for the world's existing IFIs to fully fund, and new IFIs like the AIIB will be needed to fill the funding gap. Laos offers a good example. Even though Japan is Laos' largest ODA donor, the Japanese government and the ADB have no interest in funding the Kunming-Vientiane high-speed rail project, thereby opening a funding gap which, as we have seen, China has filled.<sup>12</sup>

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