Rethinking Investments in Natural Resources: China's Emerging Role in the Mekong Region

China is establishing itself as an economic powerhouse around the world. China's economic rise and consequent demand for a reliable and steady supply of inexpensive natural resources have led to a rapid increase in Chinese foreign direct investment (FDI) stretching all the way to Africa and Latin America. The backdrop for China's growing relationship with natural resource providing countries is regional and global economic integration, which is increasingly interlinking different parts of the world in complex value-chain arrangements. This global economic system links countries belonging to the Organisation for Economic Co-operation and Development (OECD), which are the main consumers of world products, with low-income countries, which provide the majority of natural resources on which the production of goods is based. The connection is made by manufacturing countries that turn natural resources into inexpensive manufactured goods for export and sale in OECD markets. Within this global system, China over the past decade has emerged as one of the main global production and manufacturing hubs.

During the first half of 2005, Chinese enterprises invested $4.1 billion overseas, an increase of nearly 250 percent over the previous year. In 2005, the outward investments of Chinese non-financial enterprises increased by 20 percent compared to 2004 to reach $12.3 billion. In the first three quarters of 2006, China's total outward investment amounted to $14.1 billion, an increase of 80 percent year on year, and estimates pegged total outward investment at $16 billion by the end of year. Given China's rapid industrial expansion and limited domestic natural resources, it is not surprising that mining and energy are key sectors in China's foreign direct investment portfolio. China's export credit and guarantee agencies, in particular the China Export Import (Exim) Bank and Sinosure, have played an important role in fostering the rapid expansion of Chinese trade and re-thinking of China's southward investment flows. In 2005, China Exim Bank approved loans to the value of RMB 158.6 billion (approximately $20 billion). Established only in 1994, the institution has grown to become one of the world largest export credit agencies.

Partly as a result of China's rapidly growing demand for natural resources, commodity prices are rising around the globe. Investments in extractive industries that were once prohibitive are now making economic sense. In 2002, China became the world's largest consumer of copper, and it is now one of the largest consumers of alumina, zinc and nickel. In 2002 China also became the world's largest consumer of natural rubber, bypassing the US at 3.45 million tons, or 18.2 percent of total world consumption. China's demand for natural rubber is estimated to reach 11.5 million tons per annum by 2020, about 30 percent of the world's total production. This growth is directly linked to China's growing demand for vehicles, which is estimated to reach 200 million vehicles by 2020, a vast increase from the 10 million vehicles that traversed the country in 2005.

China's 'Going Out' Strategy to meet its growing natural resources demand

China's economic relationship with the world is undergoing a rapid transformation. The 10th Five-Year Plan for National Economic and Social Development (2001-2005) set out a strategy for China to proactively make use of overseas natural resources, establish overseas supply bases for both oil and gas, diversify oil imports, build up a strategic petroleum reserve and maintain national energy security. Since 2004, the country's 'Going Global' (or 'Going Out') Strategy specifically intends to meet its growing demand for natural resources, both regionally as well as globally, and spur outward investment by subsidising investment by Chinese companies in overseas natural resources acquisition. The strategy and its related initiatives include the promulgation of guidelines on outward FDI by countries and sectors, information regarding foreign countries' investment environment and opportunities, delegation of authority by the central government to certain provinces and municipalities and further relaxation of foreign exchange controls for outward investment.

The Chinese government has made laudable efforts to develop policies and guidelines to govern overseas aid and foreign direct investment. While this is still a nascent process, it has great potential for addressing and mitigating potential conflicts over investments in sensitive projects such as hydropower dams, strip mines and large-scale plantations. However, many challenges remain, as demonstrated by the guidelines for Chinese overseas investments in silviculture operations, which stipulate that Chinese companies should adhere to the laws of the countries in which they operate. In the case of the Mekong region, these laws are widely recognised as being poorly implemented. Were Chinese companies to operate as loosely as national companies when it comes to forestry or environmental regulations, this would not make for an improvement in business practices. The real leverage promised by such guidelines is that Chinese companies that bypass local regulations would not only be in violation of the laws of the host countries, but would in fact be in violation of the laws of China.

China's strategy in Mekong region

China's relationship with the three Mekong Region countries Cambodia, Lao People's Democratic Republic (Laos) and Vietnam is dynamic and complex. On the one hand, relations have never been so good. Border and sea issues are handled peacefully, eclipsed by economic interests. The close proximity of these countries eases trade flows as infrastructure improvements are connecting major regional cities and borders are open for business through international gates.

The future promises greater economic integration through the ASEAN (Association of Southeast Asian Nations)–China Free Trade Agreement (ACFTA) which will see progressive liberalisation of trade and investment between the two trading partners over the coming years. Under the ACFTA's Early Harvest Programme, tariffs on around 600 unprocessed agricultural products were already eliminated by January 2006. China's major investments within the Greater Mekong Subregion (GMS) Economic Strategy have improved the infrastructure for transporting commodities, in part through the Asian Development Bank's (ADB) GMS Economic Corridors, which includes a network of roads connecting all countries in the GMS spanning Vietnam, Cambodia, Laos, Thailand, Myanmar and Yunnan Province of China. Further connectivity is extended through an expanding regional power grid and planned railway links from Kunming to Singapore, funded in part through development assistance and investment from China. All this has enabled China to build strong bilateral and multilateral relations through investment, trade and aid with its southern neighbours and protect itself from further western influences by securing its border areas through friendly relations.

In recent years, Cambodia, Laos and Vietnam have seen two related trends working in opposite directions. The first is the partial withdrawal of International Financial Institutions (IFIs) such as the World Bank and the Asian Development Bank (ADB), which have become hesitant to invest in environmentally and socially controversial mega-projects. In recent years the IFIs have developed international standards and best practices for investment in projects with potentially large social and environmental impacts, such as hydropower, mining and industrial agriculture. These standards are often criticised by host governments as being onerous and cumbersome and it can take years for projects to get approved. This has left an investment vacuum that has been gradually filled by largely Asian financiers, and has enabled 'new financiers' such as Chinese companies to take advantage of the favourable investment climate and abundance of natural resources of its immediate neighbours.

Currently, Chinese investment banks and companies are not yet bound to similar standards in their overseas activities, even though they may be required to follow them in their home countries. China brings a different kind of investment package to the table: one that does not have benchmarks of compliance with human rights, democratic ideals and environmental protection regulations, but is built on relationships and friendship. China is also seen as a 'soft power' of culture and ideas, one making friends all across the region, with friendship spearheading business activities. For example, the Chinese government has supported the construction of several important cultural and state buildings, such as the National Cultural Hall in Laos and the new office of the Council of Ministers in Cambodia.

However, the role of China is perceived differently within Cambodia, Laos and Vietnam as well as across different social strata. The question of Chinese ethnicity is a complex and sensitive subject, with millions of people who were born and raised in the three lower Mekong countries claiming Chinese heritage. Vietnam, naturally, carries the collective memory of China as a historical colonial power. The Cambodian government is welcoming of Chinese influence and capital, but there are concerns in the countryside about dams and other Chinese-funded investment projects. The divergence between the perspectives of the elite and the grassroots on the growing influence of China presents considerable challenges for Cambodian, Lao and Vietnamese leaders. Where a civil society is emerging, people have begun to voice opposition to Chinese investment interests, as in the case of the Spratly Islands, an oil-rich area in the South China Sea. In Laos, where there are no formal civil society institutions, there has so far been no public outcry against the influx of Chinese immigrants who accompany investments. However, public concern over the proposed construction of a Chinatown satellite city in Vientiane has been widely documented in various newspapers, newswires and listserves.

China's emerging role in finance and trade in Cambodia, Laos and Vietnam

In the Mekong region, China is gaining prominence as an important bilateral trading partner and investor while at the same time emerging as a strong competitor for global markets and investments with its southern neighbours. China produces almost half of the East and

Southeast Asian region's gross domestic product (GDP) and one third of the region's exports. While China and Vietnam compete for foreign direct investment and markets around the world, China has also become Vietnam's leading trading partner. Further, China is the most important donor and foreign investor in Laos and Cambodia.

Official development assistance

The Chinese government provides considerable foreign aid to Cambodia, Laos and Vietnam, often without any major conditions attached and frequently integrated with cultural exchange and support. While significant compared to other donors, China's ODA is not often linked to the agribusiness, hydropower and mining sectors but mostly includes support for transport; communications; health, education and human resources development; and construction (of sports, culture and government building complexes) sectors. Cambodia is the only country among the three where the Chinese government has earmarked aid for hydropower development projects.

China's trade structure with its neighbours – importing resources, exporting manufactured goods

China's trade structure with Cambodia, Laos and Vietnam is presently dominated by China's imports of natural resources and exports of manufactured goods. More than 90 percent of exports from the three GMS countries to China comprise agricultural goods and raw materials. This stands in marked contrast to the structure of trade between China and some other Southeast Asian countries such as Malaysia, the Philippines and Thailand, where the trade structure is more complex and exports to China are less resource-intensive. While the relative importance of investment and trade with China varies among the three countries, what they do sell to their large northern neighbour is overwhelmingly commodities. What they buy is mostly Chinese technology, machinery and consumer goods, many of which are of low quality, but within reach of poorer consumers in Cambodia, Laos and Vietnam.

Informal (or illegal) trade in commodities is widespread in the three Mekong countries. For instance, some state officials in Vietnam estimate that the majority of the coal and rubber exported to China is informal, with no duties paid to the state and no records of the exported tonnage and value. In northern Laos it is widely known that companies from China are setting up informal operations for commodities such as sugar, cassava, corn and timber, which are then transported across the border. In parts of Cambodia it is generally suspected, though not formally confirmed, that several Chinese companies are involved in informal ventures in timber, gold and other minerals destined for markets in China.

The principal difference among the three countries in their relationship with China is in the relative importance of investment and foreign assistance versus trade in relation to the agribusiness, hydropower and mining sectors. In Cambodia and Laos, Chinese investment in all three sectors is considerable. For Vietnam, on the other hand, China is only the fifteenth largest overall investor, and Chinese investment is considerable only in the mining sector. Vietnam itself is a regional leader in hydropower and mining, with its own investments in Laos and Cambodia, and it has extensive experience in growing rubber, also with investments in neighbouring countries. For Vietnam, trade with China, its largest trading partner, is most significant in the three surveyed sectors.

China's investments in agribusiness, hydropower and mining

The natural resource sectors of the three Mekong countries have long been described as under-developed. However the emergence of China as a major investor in the three sectors as well as a principal market promises fundamental changes in the landscapes and societies of the region. Chinese state-owned enterprises are becoming major investment players in Cambodia, Laos and Vietnam and fuelling natural resources extraction. For instance, the China Nonferrous Metals International Mining Co. Ltd. (CNMIC) is active in copper mining in Vietnam and bauxite mining in Laos. Chalco (Aluminium Corporation of China) has partnered with Thai and Lao companies to put forward an environmental impact assessment for bauxite mining in the same area as CNMIC in Laos and is also engaged in Vietnam. The Sinohydro Corporation, the largest hydropower dam building company in China, is developing numerous hydropower projects in both Laos and Cambodia. And the China Southern Power Grid Co. Ltd. is either active or exploring opportunities in all three countries.

In spite of its high potential, hydropower has remained largely untapped. However, in Laos and Cambodia, China is involved in roughly 21 hydropower projects either as an investor or developer. Most of the Chinese projects are designed and implemented by Chinese companies and backed by the China Exim Bank and Sinosure, which are involved in the majority of China's overseas investments. China's current role in hydropower in Vietnam appears to be quite minor. There are no joint ventures, with most hydropower development carried out by Vietnamese firms, formerly dominated by Electricity of Vietnam. However, China supplies most of the turbines and other equipment for small and medium hydropower and Vietnam currently imports 200MW of electricity from southern China. This is expected to increase tenfold by 2015, with projected imports of about 2,000MW.

Mineral extraction has been small in scale and intensive in labour to date. However, in Laos along the Bolaven Plateau and in the Central Highlands of Vietnam, China is starting to invest in large tracts of land for bauxite mining to export aluminium for its growing construction, transportation and packaging industries. Other mining investments and/or exports in the three countries include gold, copper, iron, zinc and coal. It is expected that China will remain a large market for minerals and a key investor in the region.

Until recently, agricultural production in Cambodia and Laos was largely for local consumption and lacked intensive inputs and practices. But those days are over. China provides a major source of investment capital for agricultural inputs in the two countries and is a principal market for goods in all three. Such commodities as cassava, sugarcane, corn, palm oil, cashews and eucalyptus, among others, are major sources of investment by China in at least one of the three GMS countries. China's rising demand for natural rubber, for example, has already led its southern neighbours to convert large areas of land to rubber production. China is a major investor in rubber production in Laos, although less so in Cambodia. And while China's investment in Vietnam's rubber sector is presently negligible, China is already the principal market for its rubber exports.

Towards environmentally and socially sustainable Chinese investment

China's growing presence and role in the three Mekong countries raises new opportunities through foreign direct investment, trade and regional partnership. These new opportunities could play an important role in generating income for some of the poorest countries in Southeast Asia and building closer regional ties for both China and the countries in which they invest. But the vastly expanding demand for investment opportunities, the porous borders that facilitate informal movement of goods and people and the limited local capacity and resources to implement various regulations in the three countries presents considerable risks to these hoped for opportunities. These environmental and social risks can translate into significant impacts on riverine ecosystems, agricultural lands and communities.

China is starting to make efforts to improve its profile in the international arena by showing its willingness to take on board international best practices such as the Equator Principles for banks, public participation strategies and green credit policies, among others. However, many of the mainly state-owned Chinese companies operating in the mining and hydropower sectors continue to have a poor social and environmental track record abroad. China now has the chance to become a global leader in environmentally and socially sustainable investment by carefully monitoring Chinese overseas investments, strengthening its own investment regulations and adopting global best practices and principles. However, the onus cannot be on China alone. China will need to partner with governments within the countries it operates in to help resource providers strengthen their own regulations, which does not necessarily have to come at the expense of investment inflows.

This policy brief is part of a research project entitled ***Understanding China as an Actor in the Mekong Region***, jointly implemented by the Heinrich Böll Stiftung, WWF and the International Institute for Sustainable Development. The project aims to shed some light on China's economic role in Vietnam, Laos and Cambodia as a basis for constructive dialogue between decision makers and other stakeholders in China and the Mekong countries. This document summarises the results of a scoping study carried out at the outset of the project. The reference list for this summary can be found in the full-length study of the same name, available at:
www.boell-southeastasia.org,
www.tradeknowledgenetwork.net and www.wwf.dk.

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