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CHINA'S BELT AND ROAD INITIATIVE IN SOUTH ASIA – STRENGTHS AND ISSUES OF CHINESE ECONOMIC COOPERATION SEEN IN BANGLADESH –

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SUMMARY

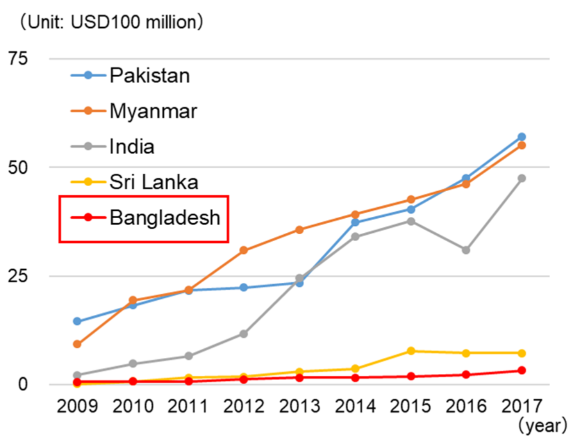
- While China has previously had limited influence in Bangladesh for historical and geopolitical reasons, it has recently been increasing its presence in the country in the power and the financial and digital infrastructure sectors.
- The strength of Chinese economic cooperation lies in its ability to provide support that meets the needs of emerging countries, coupled with its financial capabilities and cost competitiveness in infrastructure development projects. On the other hand, there are also several issues, including slow progress in execution of promised projects, and ballooning costs after contracts have been signed.
- For Japanese companies, it is necessary to seek collaboration with China, as well as with India, in Bangladesh, based on the objective evaluation of the strengths and issues surrounding China's economic cooperation.

While China's influence is growing in South Asian countries around India, such as Pakistan, Sri Lanka, and Myanmar, for historical and geopolitical reasons, it has a relatively small presence in Bangladesh, a growing market with a population of 160 million. However, Chinese influence in Bangladesh has recently been gradually growing. This report focuses on Bangladesh as a means of analyzing China's overseas expansion and explores China's Belt and Road initiative in South Asia, the strengths and the issues surrounding Chinese economic cooperation in emerging countries, and the potential for Japan-China cooperation in a third country.

THE GRADUAL EXPANSION OF CHINESE INFLUENCE

China's relatively small presence in Bangladesh can be confirmed by the trend of Chinese foreign direct investment (FDI) in South Asian countries in and around the Indian subcontinent (Fig. 1). The balance of Chinese FDI in Bangladesh at the end of 2017 stood at USD330 million, far below that for Pakistan (USD5.71 billion), Myanmar (USD5.52 billion), India (USD4.75 billion), and Sri Lanka (USD730 million). In the China-Pakistan Economic Corridor (CPEC) project, China is investing a total of USD62 billion to develop power plants, roads, and industrial complexes in Pakistan. In Myanmar, China built oil and natural gas pipelines linking Myanmar and Yunnan Province in China, and developed the Hambantota Port in Sri Lanka. While typical Belt and Road projects such as those are progressing in these countries, China's advance into Bangladesh has been fairly low key.

Fig. 1 Chinese Outward FDI by country



Source: Prepared by MGSSI based on the "2017 Chinese Foreign Direct Investment Statistical Bulletin"

This does not mean that China attaches less importance to Bangladesh. With a population of 160 million, making it the world's seventh most populous nation, the youthfulness of the population (with a median age of 25.6 in 2015), and an economic growth rate averaging in excess of 6% over the past decade (over 7% in the last three years), Bangladesh is a promising market. In its basic vision for the promotion of the Belt and Road Initiative announced in May 2017, China positioned the Bangladesh-China-India-Myanmar (BCIM) Economic Corridor linking Yunnan Province in China with Kolkata in India as one of the "Six Economic Corridors" along with the "China-Pakistan Economic Corridor" and others. In addition, when President Xi Jinping visited Bangladesh in October 2016, a total of 27 memorandums of understanding relating to economic cooperation were signed. It was reported that Chinese loans and investment in infrastructure development projects amounted to approximately USD20 billion. However, the economic cooperation promised by China is making slow progress. According to local media reports, by February 2019, loan agreements had been concluded for only 5 of the 27 projects (approximately USD4.5 billion in total), with the amount of money actually invested standing at no more than USD500 million[1].

However, a look at the balance of inward FDI according to Bangladeshi statistics shows that China's influence is gradually increasing. While the balance of Chinese FDI in Bangladesh was USD260 million as of June 30, 2017, making it the 14th largest contributor of FDI in Bangladesh by country or region[2], the latest figures for September 30, 2018 show that investment increased dramatically to USD1.25 billion, putting China in third place behind the US (USD3.61 billion) and the UK (USD1.95 billion) (Fig. 2). Viewed by industry, power accounts for USD770 million, or 60% of the balance of Chinese FDI in Bangladesh, and it is investment in the country's power sector that lies behind this recent surge in FDI from China[3].

Fig. 2 Balance of FDI in Bangladesh (USD100 mil.)

June 30, 2017			September 31, 2018		
Ranking	Country/Region	Amount	Ranking	Country/Region	Amount
1	US	33.2	1	US	36.1
2	UK	15.8	2	UK	19.5
3	S. Korea	11.6	3	China	12.5
4	Singapore	9.0	4	S. Korea	11.4
7	Hong Kong	7.6	5	Singapore	11.1
9	India	4.9	8	Hong Kong	8.1
11	Japan	3.3	10	India	5.8
14	China	2.6	12	Japan	3.5

Source: Prepared by MGSSI based on data from the Bangladesh Bank

HISTORICAL AND GEOPOLITICAL FACTORS CURB CHINESE INFLUENCE

The reason that China has had only limited influence in Bangladesh can be found in historical and geopolitical factors. When Bangladesh, which was formerly a part of Pakistan (East Pakistan), gained independence in 1971 through its war with Pakistan, India supported Bangladesh, and China supported Pakistan. Also, following independence, Bangladesh applied to join the United Nations in 1972, but China exercised its veto. Bangladesh's membership in the UN was deferred until 1974, and the establishment of diplomatic relations with China were

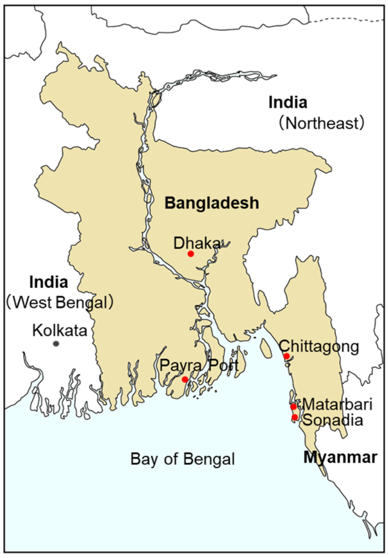
1 Jagaran Chakma "Chinese loans coming at a snail's pace" The Daily Star, 2019-2-20 (https://www.thedailystar.net/business/news/chinese-loans-coming-snails-pace-1704712, accessed March 4, 2019)

2 "Foreign Direct Investment (FDI) in Bangladesh Survey Report January-June, 2017" Statistics Department Bangladesh Bank (https://www.bb.org.bd/pub/halfyearly/fdisurvey/fdisurveyjanjun2017.pdf, accessed March 11, 2019)

3 "Bangladesh Bank Open Data Initiative" Bangladesh Bank (https://www.bb.org.bd/econdata/, accessed March 11, 2019)

delayed until 1976. Against this backdrop, Bangladesh has kept a somewhat distant relationship with China. In particular, the Awami League, which led the country's independence and which has held the reins of power since becoming the ruling party in 2008, takes a pro-India stance[4]. For Bangladesh, which is geographically encircled by India (Fig. 3), it is essential to maintain good relations with India, so it has no choice but to distance itself to a certain extent from China, which is at loggerheads with India over border disputes and other issues.

Fig. 3 Relative positions of major Bangladeshi cities



The fact that Bangladesh shelved plans for the construction of a deepwater port with Chinese assistance is indicative of Bangladesh's consideration for India. In 2014, China proposed the construction of a deepwater port in Sonadia on the country's southwest coast, but after consideration, Bangladesh eventually decided to accept a Japanese proposal for construction of a deepwater port in Matarbari, 25km away from Sonadia. Bangladeshi officials revealed that what lays behind this decision was indeed consideration for Indian and US concerns over development of a port by China[5]. India is wary of China's development of ports in the Indian Ocean at Gwadar (Pakistan), Hambantota (Sri Lanka), Kyaukpyu (Myanmar), and other sites (the so-called "String of Pearls"). It seems that Bangladesh decided that a Japanese-led port development would be much more acceptable to India. Bangladesh's decision not to send representatives higher than the ministerial level to the Belt and Road Forum held in Beijing in May 2017 also indicates its consideration for India, which did not attend the forum[6].

At the same time, Bangladesh is wary of excessive dependency on India. Bangladesh is involved in disputes with India, including one over the use of water from the Teesta River (lower Ganges). In contrast to the government level pro-Indian stance of the ruling Awami League, at the public level, the majority of whom are Muslims, there is a high degree of wariness toward its large Hindu neighbor, India. For the above reasons, Bangladesh can be said to follow a balanced diplomatic course that does not depend excessively either on India or China, and is pursuing economic cooperation with China while giving due consideration to India.

CHINA MEETING THE NEEDS FOR COAL-FIRED POWER

While China's influence in Bangladesh remains limited, it is rapidly gaining a presence in certain areas. A typical area is construction of electric power infrastructure. Construction of the Payra coal-fired power plant that is currently underway is a large-scale power project in which China is participating. This project to build an ultra-supercritical coal-fired power plant near the Payra deepwater port, which was partially opened in August 2016, is jointly funded by the state-owned China National Machinery Import & Export Corp. and a state-owned Bangladeshi corporation (a total investment of USD2.48 billion). The plant will have a total capacity of 1,320MW, and the first unit is scheduled to commence operation in November 2019, followed by the second unit in March 2020.

In addition to the China-backed Payra coal-fired power plant, construction is underway in Bangladesh on

[4] The Bangladesh National Party (BNP), the main political party after the Awami League, that held power from 1991 to 1996 and 2001 to 2006, takes a pro-China stance. However, its influence is declining and a coalition of opposition parties, including the BNP, won only 7 of 350 seats in the general election held in December 2018.

[5] Kayes Sohel "Sonadia deep sea port plan may be dumped" Dhaka Tribune, 2015-1-10 (https://www.dhakatribune.com/uncategorized/2015/01/10/sonadia-deep-sea-port-plan-may-be-dumped, accessed March 5, 2019)

[6] Taiki Koga, JETRO Business News, 2017-6-12 (https://www.jetro.go.jp/biznews/2017/06/ce5ab47418ba84cc.html, accessed March 5, 2019)

the Rampal power plant (1,320MW, supercritical), a joint venture between India's state-owned National Thermal Power Corporation (NTPC) and the Bangladesh Power Development Board, and the Matarbari power plant (1,200MW, ultra-supercritical) with support from Japan's Official Development Assistance (ODA) program.

The reason that Bangladesh is building more coal-fired power plants is to address two of the major elements of its energy policy, i.e., expansion of the country's power supply capacity and diversification of energy sources. At the end of June 2018, Bangladesh's power generation capacity stood at 15,953MW (excluding private power generation), 61% of which came from gas-fired power plants fueled by domestically produced natural gas. The government plans to expand the power generation capacity to 24,000MW by 2020 and 40,000MW by 2030 to cope with the increase in demand accompanying economic growth[7]. Since domestic production of natural gas has reached its peak, the government is looking to expand the number of power plants fueled by coal as a low-cost energy source.

In newly constructing coal-fired power plants, what stands against Bangladesh is the trend toward decarbonization among advanced countries and multilateral development banks. While construction of units 1 and 2 is underway at the Matarbari power plant and construction of units 3 and 4 is currently under consideration, Japan has indicated that it may not be able to support further construction under its ODA program.

The Chinese government, on the other hand, is actively supporting the construction of coal-fired power plants overseas as a part of the Belt and Road Initiative. In addition to two coal-fired power plants (1,320MW each) already under operation in Pakistan as a part of the China-Pakistan Economic Corridor (CPEC) scheme, plans to build a further five coal-fired power plants (total capacity 5,580MW) are proceeding as priority CEPC projects[8]. In expanding its coal-fired power plants, in addition to support from India, Bangladesh is likely to increase its dependence on China, which possesses great capital resources and a solid construction track record.

CHINA'S PRESENCE IN FINANCIAL AND DIGITAL INFRASTRUCTURE

Financial and digital infrastructure is another area in which China has a distinct presence in addition to power infrastructure. Viewed by industry, China's FDI balance in Bangladesh's financial sector (non-banking) stands at USD110 million. While this does not reach the scale of FDI in the power sector (USD770 million), finance is the third largest recipient of FDI after power and textiles (USD180 million). In 2018, there were two particularly important investments in the country's financial and digital infrastructure sector.

The first of these was the investment by the Shanghai and Shenzhen stock exchanges in the Dhaka Stock Exchange. In September 2018, the Shanghai and Shenzhen stock exchanges acquired a 25% stake in the Dhaka Stock Exchange for approximately USD120 million. The Dhaka Stock Exchange sought strategic investors as a part of its modernization plan, and the National Stock Exchange of India also expressed an interest in investment. In the end, the Dhaka Stock Exchange chose a partnership with China because the Shanghai and Shenzhen stock exchanges offered a higher price than the National Stock Exchange of India, and also promised USD37 million of technical assistance, among other reasons. The Dhaka Stock Exchange invited an IT expert as a board member from the Shenzhen Stock Exchange, and modernization of its trading system is underway.

Second was the investment by the Chinese e-commerce giant Alibaba in Bangladesh's mobile payment

7 "Bangladesh Economic Review 2018" Ministry of Finance Bangladesh (https://mof.portal.gov.bd/sites/default/files/files/mof.portal.gov.bd/page/e8bc0eaa_463d_4cf9_b3be_26ab70a32a47/Ch-10%20%28%20English-2018%29.pdf, accessed March 5, 2019)

8 China-Pakistan Economic Corridor Official Website (http://cpec.gov.pk/index, accessed March 5, 2019)

company bKash. In April 2018, Ant Financial, a subsidiary of the Alibaba Group (hereinafter referred to as "Ant"), agreed to form a strategic partnership with bKash and acquired a 20% stake in the company. bKash was established in 2010 as a subsidiary of the local BRAC Bank with equity participation from Ant as well as the International Finance Corporation (IFC), a member of the World Bank Group. The company provides money transfer and payment services using mobile phones and smartphones and currently has approximately 30 million registered users. While building and improving a QR code payment system with technical support from Ant, bKash is considering the future introduction of other services developed by Ant in China. In May 2018, Alibaba entered the Bangladeshi e-commerce market by acquiring Daraz, a leading Pakistani e-commerce company that also operates in Bangladesh.

bKash's mobile payment business is significant in the sense that it extends financial services to the poor and other groups that do not have bank accounts to promote financial inclusion. According to the World Bank's Global Findex Database 2017, although the percentage of account ownership in Bangladesh[9] rose to 50% by 2017, this is still significantly below the global average of 69% (Fig. 4). On the other hand, the percentage of the population with mobile money accounts rose sharply from 3% in 2014 to 21% in 2017, which helped to boost the percentage of account holders overall. The spread of mobile money services such as bKash is the key to financial inclusion in Bangladesh. Ant's investment and technical support for the company can be seen as socially significant in terms of its contribution to financial inclusion in the country.

Fig. 4 Percentage of Account Ownership in Bangladesh

		2014	2017
Account holders		31%	50%
	Financial institution account	29%	41%
	Mobile money account	3%	21%
Digital payment usage		7%	39%

Source: Prepared by MGSSI based on "The Global Findex Database 2017"

STRENGTHS OF CHINESE ECONOMIC COOPERATION AND ISSUES INVOLVED

As described above, although China previously has had limited influence in Bangladesh for historical and geopolitical reasons, it has recently been increasing its presence in the country, including through economic cooperation under the Belt and Road Initiative. Chinese influence is growing particularly in the power, and the financial and digital infrastructure sectors. Looking at China's approach to Bangladesh, it reveals the strengths of Chinese economic cooperation as well as the issues surrounding it.

The strengths of Chinese economic cooperation lie in its ability to provide support that meets the needs of emerging countries, coupled with its enormous financial power and the cost competitiveness of infrastructure development. While the trend among advanced countries and multilateral development banks represents a shift away from the coal, in the emerging economies there is still a strong need for coal-fired power plants to provide low-cost energy. In particular, pressing emerging countries that have not previously employed coal-fired power generation, such as Bangladesh, to advance decarbonization based on the logic and momentum among advanced countries is widely viewed as unfair in emerging countries. Chinese assistance in building coal-fired power plants meet these countries' needs. In addition, China also has the advantage of being able to address problems unique to emerging countries, such as the low percentage of account ownership, because of its experience in rapidly deploying financial and digital infrastructure such as mobile payment and e-commerce in its own country. Bangladesh has high hopes for

[9] The percentage of account ownership means the percentage of the adult population with accounts at a bank or other financial institution or with a mobile money account (users of mobile money services within the past 12 months). The Global Findex Database 2017" The World Bank (https://globalfindex.worldbank.org/, accessed March 6, 2019)

Chinese economic cooperation.

On the other hand, there are some issues surrounding Chinese economic cooperation. In some cases, Chinese economic cooperation in South Asia has led to a deterioration in the financial situation in the countries concerned or an increased trade deficit with China. This has engendered a sense of wariness towards Chinese economic cooperation within Bangladesh. Dissatisfaction is also being voiced over the delay in moving forward with the economic cooperation promised by President Xi during his visit to Bangladesh in October 2016. There are also deeply held concerns over the possibility of ballooning costs after contracts for Chinese-led infrastructure projects have been signed, as a business federation executive puts it, "Chinese companies are quick to declare force majeure". In addition, while Chinese FDI is currently focused on building infrastructure, many in Bangladesh hope for investment in the manufacturing sector that would lead to the development of local industry and job creation[10].

SUGGESTIONS FOR JAPANESE COMPANIES

Bangladesh is generally friendly towards Japan and views Japan as a trustworthy country. This is for the historical reason that Japan was the first among allies of the Western nations to accord recognition to Bangladesh in 1972 following independence, and because to the present day, Japan has continued to play a central role in economic cooperation with the country. Projects currently underway with Japanese support include construction of the Matarbari deepwater port and coal-fired power plant and the construction of MRT Line-6, Dhaka's first urban railway. The fact that the 600 billion yen worth of economic cooperation announced by Prime Minister Abe during his visit to Bangladesh in September 2014 was forthcoming as promised has also been highly appreciated.

Based on the current status of China's economic cooperation in Bangladesh, its strengths and the issues involved, the following three suggestions can be offered to Japanese companies.

First, there is a substantial need for Japan and China to cooperate in infrastructure development in Bangladesh, making use of their respective strengths. The reason for this is that although the strong cost competitiveness of Chinese infrastructure development is highly valued in Bangladesh, there are also persistent voices advocating caution over cooperating on infrastructure with China due to concerns over ballooning costs after contracts have been signed, as well as the need to show consideration towards India. Cooperation between Japan and China can already be seen in the form of partnerships between Japanese corporations and Chinese engineering companies. Recently, in October 2018, Mitsubishi Heavy Industries announced that it will construct a fertilizer plant for the state-operated Bangladesh Chemical Industries Corporation jointly with the state-owned China National Chemical Engineering No. 7 Construction Co., Ltd. under an EPC (engineering, procurement, and construction) contracting arrangement. In addition, some sections of MRT Line 6, which is being constructed with financing from the Japan International Cooperation Agency (JICA), are being constructed by the Chinese state-owned company Synohydro Corporation. Japanese-Chinese cooperation in this form is expected to increase in future.

Secondly, it is necessary for Japanese companies to view positively the fact that Chinese economic cooperation has the strength to cope with societal issues unique to emerging countries, and to pursue new opportunities that can be derived from that strength. For example, when Japanese companies enter the Bangladeshi consumer market, which is expected to continue expanding, they need to consider how to make the best use of the financial and digital infrastructure, such as mobile payment services and e-commerce, in which Alibaba and other Chinese companies are actively involved.

Thirdly, the possibility of Japanese-Indian cooperation in Bangladesh can also be considered, in addition

[10] Based upon interviews with government bodies, business organizations, local companies, and other parties conducted by MGSSI in Dhaka in January 2019.

to Japanese-Chinese cooperation in the country. While railway links between Bangladesh and India are being developed and the power grid is being expanded with a view to increasing the import of electricity from India, Bangladesh is wary of excessive dependence on this neighbor. For Japanese companies, it will also be important to cooperate with India in infrastructure development in Bangladesh, and to pursue new opportunities emerging from the closer economic ties between India and Bangladesh through infrastructure development.