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Understanding China's Role as a Development Partner in Sarawak

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SYNOPSIS

China has become an important development partner in Sarawak. Yet this role has become largely technical rather than financial, as the state government has shifted to assert greater control over strategic sectors. Changes in the Sarawak government's future development priorities may also dilute China's prominence as a development partner.

COMMENTARY

China has come to play a prominent role in Sarawak's development projects over the last decade. Chinese firms have been instrumental in building up the state's renewable energy capacity and physical infrastructures, both critical pillars within the state government's long-term development plan.

However, China's role in providing foreign direct investment (FDI) has remained modest in Sarawak's development projects, as the state government increasingly takes over the financing of such projects. This limited financial involvement has rendered Chinese firms as technical partners rather than investors in development projects.

This is a key departure from similar projects elsewhere in Malaysia, and likely reflects the priorities of the Sarawak government, which is well-known for asserting greater financial and administrative control over key economic sectors than other state governments. Shifts in its development priorities and partnerships with other foreign players may also limit China's potentially prominent role in Sarawak's future development.

China's Rise as a Major Development Partner

An abundance of low-cost renewable energy has been the backbone of the Sarawak government's development strategy since the implementation of the Sarawak Corridor of Renewable Energy (SCORE) in 2008.

This development strategy focuses on building hydropower dams by tapping into Sarawak's riverine geography. The excess energy generated would in turn allow the state government to set attractive tariffs in order to draw energy-intensive industries to Sarawak, spurring manufacturing activities that would deliver spinoffs for local businesses and value-added jobs for Sarawakians.

China's growth as a major development partner in the state followed the Sarawak government's shift to play a greater role in the state's development vis-à-vis the federal government.

The state government actively courted Chinese hydropower corporations between 2007-2010 to revive the federally-led hydropower Bakun Dam project. This mega project had been shelved repeatedly since construction began in 1986, due to funding constraints and pressures from local and international communities over its negative environmental and social impacts, which had earlier led its original Australian partners to withdraw.

China, globally reputed for its engineering expertise and leading role in building hydropower dams, was well positioned to meet Sarawak's demand for hydropower and physical infrastructure. Importantly, an attractive part of China's overseas development assistance packages was the provision of financing without social or environmental governance conditions.

Bakun, the state's largest-capacity dam, was completed in 2011 after China's state-owned enterprise (SOE) Sinohydro took over in a joint venture with federal SOE Sime Darby, with loans obtained from China's EXIM Bank.

Sarawak has since relied on partnerships with Chinese SOEs to develop other major hydropower plants, such as Murum and Baleh. Chinese firms have also played a major role in building supporting infrastructure such as power stations, major roads, bridges and port upgrades.

Limits to Chinese Involvement in Development

Several factors, however, have limited China's financial involvement as a development partner in the state post-Bakun. Chinese capital remains modest in Sarawak's strategic development projects compared to its role in other major projects across Malaysia, such as the East Coast Rail Link (ECRL) and the Trans-Sabah Gas Pipeline projects.

Part of the reason is structural, as public and private funding under SCORE are sectorally divided. Infrastructure projects are financed by the federal and Sarawak governments, thereby limiting both foreign and private investments. This departs from the trend of infrastructure financing elsewhere in Malaysia, where public-private partnerships (PPPs) have become increasingly common as federal allocations for development projects dwindled.

Instead of turning to FDI, however, the Sarawak government has expanded its role in financing or raising funds for infrastructure and energy projects in a bid to assume greater control of strategic sectors vis-à-vis federal power, and to ensure that the state maintains its pace of development.

This shift to a more direct role in financing development projects gained traction in 2017 when Abang Johari took over as Chief Minister. The state leader established the Development Bank of Sarawak (DBoS) to finance strategic infrastructure projects, with its funds purportedly drawn from the state government and government-linked bodies. However, the lack of transparency over actual funding sources and values has raised concerns among opposition politicians over the government's fiscal capacity to sustain the state's development momentum.

On the other hand, where energy projects under SCORE are meant to be privately financed, the state government has also increasingly assumed this role through its state-owned corporation, Sarawak Energy Berhad (SEB). SEB has financed major energy development projects post-Bakun, with funds raised internally and through Islamic bonds. SEB also purchased Bakun Dam from the federal government in 2017, finalising its ownership over all energy projects in the state.

Given the need to rapidly build energy projects, SEB's monopoly over the sector as funding body, owner and power supplier has enabled it to not only maximise economic rents for state coffers but, importantly, to streamline project implementation. In effect, the federal government is largely side-lined as a decision maker. Indeed, compared to the decades-long Bakun project, which had been repeatedly suspended by the federal government, construction of the SEB-financed Murum Dam was completed within six years, while Baleh Dam, if completed in 2027 as scheduled, would take nine years.

Sources of funding for SEB's Islamic bond programme, however, remain obscure. While data on source countries are not available, SEB's website, declaring a mix of "foreign and local financial institutions including pension funds, asset management companies, banks and insurance entities", suggests an attempt to diversify funding sources post-Bakun.

The impact of the state government's expanded role in driving and financing development projects through SEB and DBoS has limited Chinese FDI in both infrastructure and energy post-Bakun. While this has not undermined China's role as a key technical partner, the state government has retained control over contract terms, potentially limiting Chinese firms' ability to impose conditions on the use of Chinese contractors, suppliers and workforce – requirements commonly seen in EXIM Bank-financed projects.

China's Outlook as a Development Partner

Given the Sarawak government's strong hand in directing the state's economic growth, China's outlook as a development partner is tied to changes in the state government's future capacity to fund projects as well as to shifts in its development priorities.

While the state government's expanded role to finance development projects has sidestepped FDI, an over-reliance on public funds may prove difficult to sustain, particularly when the state government is also moving to support new economies. This may see Sarawak adopting models of development financing similar to the rest of Malaysia, incorporating more private sector investments from foreign and local sources alike.

Moreover, China's prominence in the energy sector also shows signs of slowing, as plans to construct hydropower plants in the state appear to have stalled. The government's recent shift towards hydrogen has also seen the entry of other foreign partners in the sector.

For instance, the state government has established a technical partnership with UK-based firm Linde to conduct research and development. It also signed several agreements with firms in Japan, South Korea and a French-Australian joint venture to develop hydrogen production plants. China's involvement in hydrogen, on the other hand, has thus far been concentrated in the supply of hydrogen-powered vehicles, including a fleet for Kuching's planned urban rail system.

The diversification of Sarawak's energy landscape need not be a negative outcome for Chinese firms nor does it undermine China's economic import in the state. Rather, it reflects a new phase of Sarawak's ongoing development, presenting new opportunities for partnerships.

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