

Risk Assessment of Malaysia East Coast Rail Link Project

Hanwen Ye

Yunnan University of Finance and Economics, Kunming, Yunnan, China

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Abstract: The east coast rail link project (ECRL) is the largest economic and trade cooperation project between China and Malaysia up to now. This paper makes a risk assessment of ECRL project from the perspective of Chinese enterprises and proposes possible solutions.

1. Introduction

This paper makes a risk assessment of ECRL project from the perspective of Chinese enterprises and proposes possible solutions.

The east coast rail link project (ECRL) is the largest economic and trade cooperation project between China and Malaysia up to now. The project is undertaken by China Communications Construction Co., Ltd (CCCC) with a total contract value of about 55 billion Ringgit which was signed by the Chinese government and Najib, the former prime minister of Malaysia in 2016.

ECRL connects several key cities in Malaysia, with a total length of 688.3km. The project adopts China's first-class passenger and freight dual-use standard electrified railway. The design speed of passenger train is 160 km/h, and that of freight train is 80 km/h. The estimated construction period is 7 years and the maintenance period is 2 years. Construction on the ECRL project was started in Kuantan, Malaysia, in August 2017, whereas the work was paused in 2018 because of funding issues. Construction was resumed in July 2019 and is expected to be completed in December 2026.

The ECRL project is highly valued by the Chinese and Malaysian governments. Design standards, technology integration, safety, quality and environmental protection requirements are high. In addition, the project itself has a large scale and a long duration, and there are many and wide distribution points along the subgrade, bridge and tunnel, so the construction organization and coordination management will face great challenges.

A joint venture was formed between CCCC and Malaysia Railway Corporation (MRL), with each holding 50 per cent equity and sharing operational risks and technical support after the project is completed. The involvement of local contractors in ECRL's civil works will increased to 40% by the collaboration between MRLSB and CCCC. Bilateral relations between both countries will also be improved to a great extent.

The project is expected to create employments which worth MYR17.6bn (\$4.2bn) during the construction. It will boost the development of small and medium enterprises, while increasing demand for housing, supplies, and transport in the regions along the East Coast Rail Link.^[2] In addition, the completion of the Kuantan Port to Klang Port section of the Middle East railway will reduce transport time between the two major ports, greatly improving the efficiency and safety of transport between the two places and helping to boost trade in the region.

When the project is put into operation, the revenue from the project will mainly consist of two parts, freight and passenger transport, which are expected to account for 70% and 30% of the total revenue of the railway network respectively.

The project is of great significance to the planning of the eastern coastal economic zone of Malaysia, promoting the balanced development of the eastern and Western economies of Malaysia, and improving the transportation system of Malaysia.

2. Risks

2.1 Political Risk

Malaysia is a member of the Commonwealth, one of the five founding member countries of ASEAN, and a founding member of the group of 77 and the nonaligned organization. It takes independence, neutrality and non-alignment as its foreign policy, regards ASEAN as the cornerstone of its foreign policy, attaches great importance to developing relations with major countries and actively promotes regional cooperation in East Asia. Since the U.S. proposed the 'return to Asia Pacific' strategy, the U.S. strength has strengthened its influence on the political situation of Malaysia, which poses a danger to relations between China and Malaysia. Malaysia is strategically sensitive, but its own strength is relatively weak, and its foreign policy is often constrained by powers such as the US.

In the 13th annual election in 2013, the 'National Front' under the leadership of Najib, the former Malaysian prime minister, encountered great challenge from the opposition coalition, promoting social justice and anti-corruption agenda of people's justice party and religious extremist Islamic party, largely scattered the originally solid Malay ethnic groups of the vote. This made the united Malay national organization (UMNO) realize that "identity conservatism" alone could not stabilize the fundamentals of the Malay vote, and it had to keep the legitimacy of its regime in coordination with "economic development" and other livelihood issues. Therefore, in his second term, Najib began to actively respond to the Belt and Road Initiative and vigorously introduce Chinese investment to develop his country's economy.

During the election campaign, however, Mahathir launched a fierce attack on the national front government over Najib's aggressive introduction of Chinese investment. He declared that Malaysians 'did not benefit from Chinese investment' and promised to carefully review some large-scale foreign investment projects launched during the Najib administration after the election victory as an important political commitment of the Pakatan Harapan government. On May 9, 2018, Malaysia held a general election. The opposition party alliance 'Pakatan Harapan' led by Mahathir Mohamad, a 92 year old former prime minister, defeated the ruling party 'National Front' at one stroke and won more than half of the seats in the lower house of Parliament, thus tying up the National Front's rule for more than 60 years and realizing the first party rotation in Malaysia since independence. This result is unexpected for most observers and is quite different from the results of the major polls before the election.

After the Pakatan Harapan government came to power, it initiated a series of renegotiations and strict reviews on a series of major engineering projects (such as the 'East Coastal Railway') participated by Chinese enterprises by taking advantage of the problem of excessive national economic liabilities, which brought a series of uncertainties to China's investment security in Malaysia.

Because Pakatan Harapan won the general election for the first time in 60 years, both the cabinet and the Congress were in a situation of multi-party balance. No party can play a decisive role either in the cabinet or in the parliament. All major political parties are fighting for their own interests. There are constant contradictions among the members of the ruling coalition, and it is possible to

separate ways at any time. This fundamentally determines that Malaysia will face a fierce political struggle in the future. The fierce political party struggle has also brought many uncertain factors to the investment in Malaysia, resulting in a great negative impact.^[1]

2.2 Economical Risks

Since 1970, Malaysia's economy has transformed from a country largely dependent on exports of raw materials into one of the strongest, most diversified and fastest-growing in Southeast Asia. The country remains a major producer of rubber and palm oil, exports large amounts of oil and gas, and is one of the world's largest sources of commercial hardwood. Malaysia has increasingly placed emphasis on export-led manufacturing to drive its economic growth.^[2]

Malaysia is the second largest producer of oil and gas in southeast Asia, also the world's third largest exporter of liquefied natural gas (LNG), thus the energy industry is the pillar industry of finance. Due to the country's financial dependence on the oil and gas industry, the fall in international crude oil prices in recent years has directly affected the Malaysian federal government's revenue. The Ministry of Finance estimates that a \$1 drop in international crude oil prices has cost it nearly 300 million ringgit in lost revenue. Since the second half of 2014, the drop in international oil prices has directly caused the Malaysian government to lose about 30 billion ringgit in government revenue. The operating profits of nearly 3500 international oil and gas consulting and engineering services companies in Malaysia were also affected, indirectly negatively affecting the country's tax revenue.

2.3 Social Risk

Malaysia is a multi-ethnic country with 32 ethnic groups. Malays, Chinese and Indians are the three major ethnic groups of Malaysians. Bahasa Malaysia is the national language, which is generally used in English and Chinese. Islam is the state religion of Malaysia, mainly Sunni, Buddhism, Taoism, Malaysian, Christianity, Sikhism, etc. Due to the long term coexistence of many ethnic groups, Malaysia has formed its unique multiculturalism, which may be affected by local cultural differences for cross-cultural business investment.

The ethnic conflicts among Malays, Chinese and Indians are the main social contradictions. Since 2008, ethnic relations have been tense. Although there has been no ethnic conflict, all ethnic groups actively strive for interests under the existing policies. There is exclusion and discrimination against Chinese in the society, and the interest of Chinese is to strive for more reasonable national resources. The Malays want to maintain their privileges, and the existing reform measures guarantee their vested interests, which makes the government have to lean towards the Malays while pursuing the one Malaysia policy. At present and in the future, the relationship between Malays and Chinese will continue to be tense, but there will be no conflict and the situation will be basically stable. Before and after the 2018 general election, there will be repeated small-scale demonstrations or anti-government riots in Malaysia, with unstable factors.

3. Solutions

Political risk is the most serious among many risks. New president Mahathir has repeatedly said that Malaysian people have failed to benefit from some

Chinese funded projects, so they need to review investment projects from China again. Malaysia wants to terminate the eastern coastal railway project, in the final analysis, because it is unable to bear the project interest of about 817 million yuan per year. Against the background that Malaysia's fiscal deficit is 3.7% of GDP and the scale of national debt is about 1.6 trillion yuan, the annual

engineering interest of the eastern coastal railway project is about 800 million yuan, which undoubtedly increases Malaysia's fiscal expenditure, makes the fiscal deficit increasingly serious and hinders the healthy development of the local economy.

In view of financial risks, Chinese enterprises should always pay close attention to and collect financial information such as Malaysia's debt level, interest rate and stock futures index. In the process of project financing, Chinese enterprises should optimize the structure of interest rates of loans, control the cost of financing, loan interest rates will rise as the Malaysian financial market money supply, loan interest rates rise when should use fixed interest rate, the fixed rate proportional control in about 70% of the total loan, on the other hand, the loan interest rate will be as the Malaysian financial market tend to go down in the excess money supply falling interest rates should choose a floating interest rate loans. The balanced distribution of fixed interest rate debt and floating interest rate debt in loans can reduce financial risks and benefit losses in project financing.

Social risks are caused by the ethnic and religious differences between China and Malaysia. It is necessary to fully understand the ethnic, religious and cultural differences between Malaysia and China, respect the religious beliefs and ethnic customs of Malaysia, and strengthen the localization of employees. Chinese enterprises should hire more Malaysian labor force and management talents, respect their ethnic and religious differences, and increase the opportunities for Chinese enterprises to integrate into Malaysian culture.

Conclusion

This paper expounds the political risks, economic risks and social risks in the operation of ECRL project, and provides possible measures to deal with the risks. As the largest project of China-Malaysia cooperation so far, the risks of project financing is typical and widely exists in other Financing projects in Malaysia. For similar financing projects in Malaysia, Chinese enterprises can take the risks of ECRL project as a reference to minimize the occurrence of similar risks.

References

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