

The China-Laos Railway: A “Game Changer” for Laos?

By YU Hong

After five years of construction, the high-profile China-Laos railway project connecting Kunming, the provincial capital of China’s Yunnan province, to Vientiane, the capital of Laos, has been completed. It has formally been in operation since December 2021. On 3 December 2021, Xi Jinping, China’s president, held a virtual meeting at the official opening ceremony with his Laotian counterpart, President Thongloun Sisoulith of Laos. This reflects the significance of the China-Laos Railway to both nations.

This transnational railway is 1,035 kilometres long, with the China section constituting 613 kilometres and the Laos section at 422 kilometres. The China-Laos railway (henceforth the railway) is dedicated to both passenger and freight traffic services; its passenger trains run at a speed of 160 kilometres per hour and freight trains at 120 kilometres per hour. The railway will be operated and managed by Laos-China Railway Co. Ltd., a joint venture between China Railway Group Conglomerate (70% owned) and Laos National Railway State Enterprise (30%) under the Laos Ministry of Public Works and Transport.

The China-Laos Railway is a key mega project of China’s Belt and Road Initiative (BRI) in Southeast Asia.¹ The completion of the railway demonstrates that the BRI remains on track despite the COVID-19 pandemic and the fast-changing global geostrategic environment.

The railway is the biggest public infrastructure project ever undertaken by Laos. It is part of a grand plan to build a Pan-Asia railway that will ultimately connect China, Laos, Thailand, Malaysia and Singapore.

The railway has created a new link between Laos and China, Laos’ neighbouring country and closest partner. The Laos section has 10 passenger stations along the line that stretches from

¹ Yu Hong, “China’s Belt and Road Initiative and Its Implications for Southeast Asia”, *Asia Policy*, 24 July 2017.

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its mountainous north to the hinterland region. The railway is also connected to the domestic high-speed railway network in China.

To construct the railway, Chinese companies and engineers had to build 200 kilometres-long tunnels and 160 bridges (with some crossing the Mekong River) to run the rail tracks due to the mountainous terrain in northern Laos.² Technically, the railway is a showcase of China's strength in railway construction and engineering.

Laos has few skilled construction workers and little experience in building large-scale railway projects on its soil. The domestic industries in Laos are also unable to supply most of the raw materials and equipment for railway project construction. Chinese banks and firms, engineers and workers have from the beginning been heavily involved in project financing, technical standard setting, project design, construction, material and equipment supply, as well as local training for workers.

LAOS' LAND-LINKED ECONOMIC DEVELOPMENT STRATEGY

Laos is the only landlocked country in Southeast Asia. According to the Global Competitiveness Report 2018,³ domestic infrastructure development in Laos is very limited and backward, regionally as well as globally. Laos is also ranked as one of the poorest among ASEAN (Association of Southeast Asian Nations) countries.

For years, the Laotian economy has suffered from a lack of diversification, relying heavily on hydropower generation and its mining sector. These activities are environmentally unfriendly and unsustainable. The railway could open up opportunities for economic diversification by making two-way travel for facilitating both passengers and freight between Laos and China.

The Laotian government leverages infrastructure improvement as part of its land-linked economic development strategy to drive economic growth; the endorsement of the railway project is to boost economic activities ranging from agricultural production to export-oriented manufacturing, tourism and logistics services. To many Laotians, the railway is a source of national pride.

Compared to the 15-hour journey by road transport, the railway will substantially reduce transport time for passengers and freight from Vientiane to Boten, a town on the Laos-China border, to around four hours.

Furthermore, according to a World Bank empirical estimation in 2020, the China-Laos railway could reduce domestic transport costs by 20%-40% in Laos, and reduce the cross-border transport costs between Kunming and Vientiane by 40%-50%, representing a reduction of about US\$30 per tonne.⁴ Laos hopes to increase its export earnings with the better access and increase in exports to the huge Chinese market.

² Nick Freeman, "The Kunming-Vientiane Railway: A Post-pandemic 'Deus ex machina' for the Lao Economy?" ISEAS Perspective, No. 158, 30 November 2021.

³ World Economic Forum, "The Global Competitiveness Report 2018", pp. 1-656, Geneva, Switzerland, available at <https://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf> (accessed 5 December 2021).

⁴ World Bank, (2020). "From Landlocked to Land-Linked: Unlocking the Potential of Lao-China Rail Connectivity".

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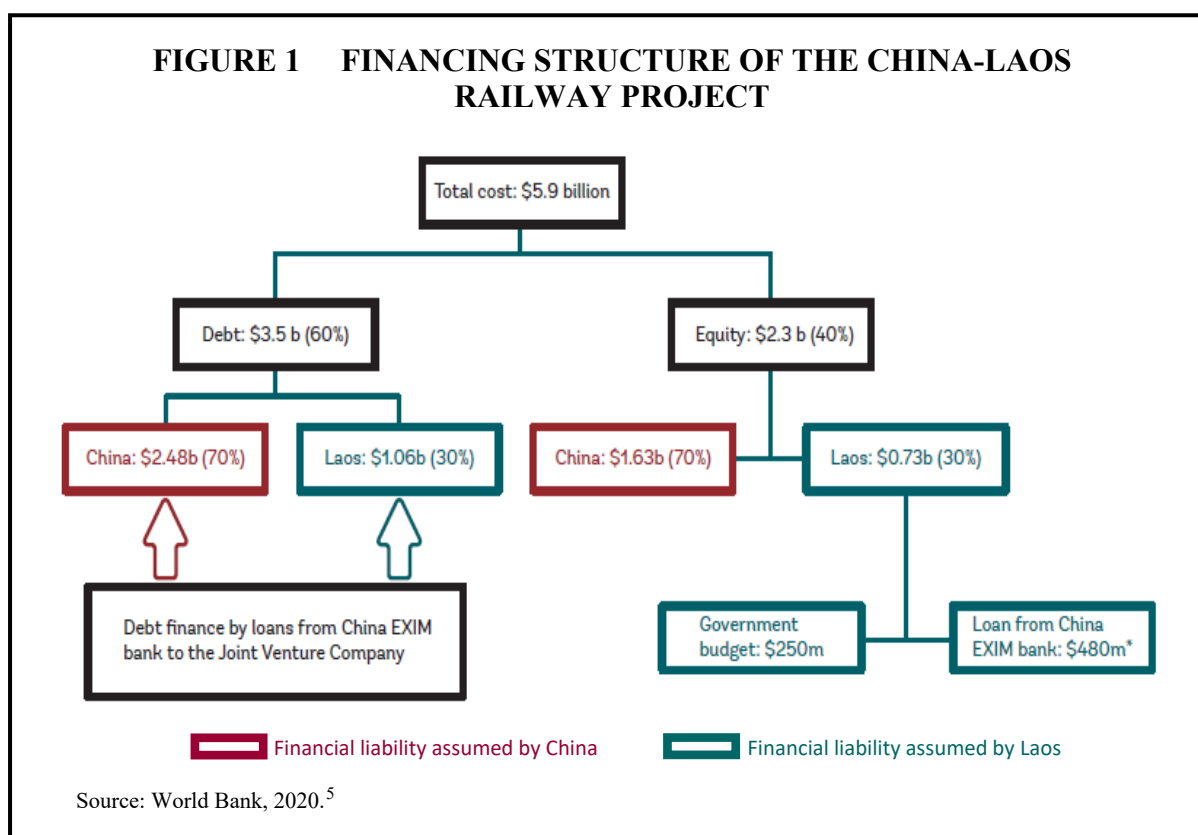
The Laos economy is also highly dependent on its tourist trade. China has become an increasingly important market for the Laotian tourist industry, accounting for around 15% of its tourist market. The railway will pass through many of its tourist attractions, such as Laos' UNESCO world heritage site of Luang Prabang, and Pu'er and Xishuangbanna, two famous domestic tourist sites in China. The Laotian government believes that as Chinese tourists are used to travelling by railway, the operation of the new railway will attract more Chinese tourists to travel across the border into Laos.

The Laotian government aims to attract one million Chinese tourists to Laos, thereby increasing foreign exchange earnings from inbound Chinese tourists once the coronavirus pandemic is over and cross-border passenger traffic resumes.

FINANCING STRUCTURE OF THE RAILWAY PROJECT

Although Laos has a small and agricultural-based economy, its investment in railway development has been substantial, at US\$5.9 billion (the equity/debt ratio is 40:60), or equivalent to around one third of Laos' gross domestic product in 2019 (estimated at US\$19.14 billion). One third of the 40% equity (US\$250 million) is taken from its budget, while the remaining US\$480 million of its equity stake is financed by a loan from the Export-Import Bank of China (Eximbank). Of the debt financed by loans, Laos' part of the liability is US\$1.06 billion or one third of the loan. In total, for the construction of the railway, the US\$1.54 billion debt incurred is guaranteed by the Laotian government (see Figure 1 for project financing).

Laos' external debt distress is high given its low foreign exchange reserves. The major financier for the railway project, Eximbank, has provided around 70% of the total funding in loans.



⁵ Ibid, pp. 1-100.

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The Laos economy was hard hit by the COVID-19 pandemic. Growth was down to -0.4% in 2020, the lowest in three decades according to the World Bank. For an economically underdeveloped nation like Laos, critics question the necessity for the country to build such an expensive railway based on cost-benefit analysis. Within this narrative, Laos' budget is so limited and public financing is in such a dire situation that construction of such a project makes no economic sense.⁶

Laos' overall debt has indeed been exacerbated due to the sharp increase in external debt attributed to BRI projects such as the railway. In January 2021, in a speech given at the five-yearly national congress of the Lao People's Revolutionary Party (LPRP), the ruling party in Laos, General Secretary of the LPRP Central Committee Thongloun Sisoulith acknowledged that Laos' internal public financing is facing grave difficulties due to the pandemic and the debt situation.⁷

The estimated 50% of Laos' accumulated external debt is held by China, which is becoming Laos' largest creditor. Nevertheless, since the China-Laos railway is a landmark project in mainland Southeast Asia under the BRI, it is not in China's interest to bankrupt its neighbour on account of the railway project. That would negatively affect the image of China's BRI and its push for implementation abroad.

RIDING A BUMPY ROAD

The railway is dedicated to both passengers and freight transport services. On its part, Laos is keen to leverage the railway to turn the country's strategic location into an asset. Due to its debt liability, the country will do whatever it can to avoid the railway becoming a "white elephant" project marred by under-usage of both passengers and freight traffic. To finance its debt, Laos has to make the railway work in the long term.

If the conditions are right, the China-Laos Railway has the potential to be a game changer for the Laos economy. Nevertheless, the railway itself is not a panacea. Much depends on how the Laotian government, corporate sector and local community make it work to reap the tangible economic benefits that it offers.

Meanwhile, connectivity depends on both hardware and software infrastructure development. Following the completion of the hardware infrastructure of the railway, the key now is to implement efficient cross-border processes and swift border clearance procedures.

From the viewpoint of the local business communities of Laos, China and foreign investors, border clearance time and procedures remain cumbersome. This is confirmed by various logistics and custom clearance indicators applied by many multilateral organisations such as the World Bank and World Economic Forum.

Domestic reforms are thus urgently required to improve overall business and investment environment. For the railway to operate efficiently and to cut freight costs, both cross-border customs clearance procedures and border management have to be simplified to minimise traffic delays. Enhancement to road connectivity between railway stations and centres of production,

⁶ John Reed, "Laos to Open Chinese-Built Railway amid Fears of Beijing's Influence", *Financial Times*, 2 December 2021, available at <https://www.ft.com/content/822dfa7f-3ca6-4b0f-a6e8-ddef820b404e> (accessed 3 December 2021)

⁷ "Laos Communist Party Elects Thongloun as New General Secretary", *Xinhua News*, available at http://www.xinhuanet.com/english/2021-01/15/c_139670561_2.htm (accessed 3 December 2021).

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and between railway stations and tourist destinations is also necessary to boost usage by companies and passengers.

At the time of writing, amidst the global COVID-19 pandemic, cross-border travel for passengers between China and Laos remains restricted. Freight will thus continue for some time to be the main form of traffic for the railway, primarily for the transport of Laos' exports of agricultural products to China, and for China's exports to Laos, such as iron, steel, machinery, fertiliser and cement. An estimated 3.7 million tonnes of freight between China and Laos could be transported by railway by 2030, including a partial shift of freight traffic from the maritime routes to the railway. Based on the forecast volume of freight transport and the transport cost of US\$40-US\$62.3 per tonne, between US\$148 million and US\$230 million of freight transport revenue could potentially be generated for the railway by 2030 depending on the efficiency of the China-Laos railway and cross-border management, as well as the connected railway section in Thailand for transit shipment. Nevertheless, such revenue will not be sufficient to cover the costs of the railway for decades to come.

Passenger transport revenue could not be estimated in view of the cross-border travel restrictions imposed due to the current COVID-19 pandemic. There is currently no sign of the cross-border passenger traffic restrictions being lifted anytime soon. The two countries have already announced that cross-border passenger train services will not start until the pandemic is over.

For Laos, a small and underdeveloped economy with a population of around seven million, increasing passengers and freight volume in both directions of the railway will be a challenging task. To avoid reliance on foreign tourists and the danger of the railway being used only in the China to Laos direction, it is essential to boost domestic rail travel among the Laotian people. The price of a one-way ticket between Vientiane and Boten was officially set at RMB132 (Laotian Kip 238000) to RMB294 (Laotian Kip 529000), a price that could be too expensive for many ordinary Laotians.

YU Hong is Senior Research Fellow of the East Asian Institute, National University of Singapore.

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