Right on Track or off the Rails?
The Impact of the Laos-China Railway on Lao PDR

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Abstract

On 02 December 2021, the nation of Laos witnessed the inauguration of the Laos-China railway, the country's first modern railway line and one of the first overall major BRI projects to be completed. Supposed to transform Laos from a landlocked country to a land-linked hub, the railway brings both considerable benefits as well as risks for the Southeast Asian nation.

Keywords: Laos, China, BRI, Rail

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Right on Track or off the Rails? - The Impact of the Laos-China Railway on Lao PDR

This year’s Lao National Day, 2 December 2021, marked a historic date. The people of the Lao People’s Democratic Republic (Lao PDR) witnessed the inauguration of the country’s first modern railway line, the Laos–China railway. It officially began operations the following day, connecting the Lao capital of Vientiane with the Chinese provincial capital Kunming. It is one of the first overall major Belt and Road (BRI) projects to have come to fruition.

However, while proponents of the project argue that it will significantly benefit the country both economically and socially, critics see it as an expensive luxury that will greatly extend Chinese influence in Laos and pull Southeast Asia further into China’s orbit.

While it is certainly too early to reach a final verdict on the merits of the railway initiative, this EIAS Policy Brief seeks to provide an overview of this Sino-Lao endeavor and will explore potential risks and benefits resulting from the project for the Lao PDR. Additionally, the article will draw a brief comparison to the planned Budapest-Belgrade railway line and highlight the opportunities resulting from the incipient global infrastructure competition.

From landlocked to land-linked

The more than 1,000km Chinese-built, single-track line passes through previously near impenetrable mountainous terrain, which can now be traversed at speeds of up to 160km/h. Connecting Vientiane to the border city of Boten, the approximately 417km spanning Lao section alone consists of 62km of bridges and 198km of tunnels, with even higher figures on the Chinese side. After five years of construction, the project was completed on schedule, with the first of the Chinese standard electric multiple unit trains being delivered to Laos in mid-October 2021. The rail is much safer than the existing road infrastructure, which suffers from poor maintenance and problems such as overloading of trucks and increasing occurrences of extreme weather events associated with climate change. The new railway will cut travel time between Vientiane and Boten from 15 to just 4 hours and between Vientiane and Kunming from well over a day to approximately 10 hours. However, due to the ongoing Covid-19 pandemic and subsequent travel restrictions, crossborder passenger services will be suspended until further notice, leaving only goods to traverse the border.

Nevertheless, despite the ongoing global pandemic, completing the project on time has been of the utmost importance, especially for China. In recent years, BRI critics became increasingly vocal while many of its larger projects have been delayed. Therefore, the railway link’s timely completion serves as a welcome change of narrative, particularly considering the symbolism of 2021, marking the 60th anniversary of Laos–China diplomatic relations. The ambitious rail link constitutes the largest infrastructure project in the history of Laos and is envisioned to transform the nation of 7 million people, “from a landlocked country to a land-linked hub” in Southeast Asia. Thought of as a key component of an ambitious Pan-Asia rail network, the Laos-China railway is intended to eventually connect the Chinese market to economic centers in the South. Thus, it is ultimately supposed to reach as far as Singapore. Meanwhile, after numerous delays and even the temporary cancellation of the project, construction on the Thai railway section is set to be completed by 2028. Eventually it will connect the northern border town of Nong Khai, at the Thai-Lao Friendship Bridge, with the deep sea port in Laem Chabang via Bangkok.
Considering this, critics have voiced concerns that the railway would merely transform Laos into a transit space between its economically attractive southern neighbors and the PRC, without generating considerable economic benefits for the Lao PDR itself. However, the Lao leadership hopes for the project to stimulate the economy by inter alia boosting tourism and benefiting from reduced transport costs of up to 50% as well as intensified trade relations, particularly with China. Indeed, a 2020 World Bank report noted the project’s long-term potential to raise the national income level by up to 21%, as it “could provide Lao PDR with a land link to global and regional supply chains, which could make the country more attractive to investors, create new jobs, and accelerate economic growth”. Yet, in order to fully realize the project’s potential, the country has to implement a number of reforms and structural improvements. The World Bank report made several recommendations regarding the maximization of the railway’s efficiency. Suggestions referred to the establishment of an effective transit regime including efficient border controls, ensuring transparency and uniformity of relevant regulations, as well as the modernization and harmonization of relevant public agencies. In addition, strategic investments in both infrastructure and businesses should be made along the Lao section of the rail corridor and its eventual 23 stations, of which at least 10 will facilitate passenger services. In addition, supportive infrastructure such as access roads, storage facilities, and expressways connecting the rail to neighboring regions in Laos and Thailand will need to be built in order to attract businesses and further investments. In that regard, Laos is already taking important steps by constructing an express road connecting Vientiane with Boten and Kunming. The road is jointly built by the Lao government and China’s Yunnan Construction and Investment Holding Group, with the Chinese company controlling 95% of the endeavor.

The country will need to develop a well-structured reform and action plan that recognizes immediate needs while formulating a clear long-term vision for structural development along the corridor. This is to ensure a positive impact on Laos’ economy and to secure a return on the construction investments made. Hence, the project’s viability ultimately depends on the Lao government’s willingness and capacity to enact comprehensive reforms and targeted investments. In this regard, the Vientiane Times reported that in early November 2021, the Lao People’s Revolutionary Party (LPRP) Politburo agreed to a government plan for the further development of the railway until 2030, however not without tasking relevant government bodies to amend the plan and map out concrete areas for joint development with China. On 19 November 2021, Lao Deputy Prime Minister and Minister of Planning and Investment Dr Sonexay Siphandone met virtually with He Lifeng, head of China’s National Development and Reform Commission, to sign both a memorandum of understanding on further economic collaboration, as well as an agreement to reaffirm cooperation on 32 joint development projects, such as the construction of new expressways. Furthermore, China reportedly offered to aid Laos in the development of its action plans to enhance trade, investment and tourism near the railway.

The Economics of Laos-China relations

This mega-project, jointly managed through the newly created Laos-China Railway Co., Ltd., will certainly continue to bind Laos and China closer together. The last two decades already saw an enormous increase of Chinese engagement in Laos. In fact, with more than 10 billion USD in the last 20 years, China rose to become Laos’ largest source of Foreign Direct Investment (FDI) ahead of Thailand (4.7 billion USD) and Vietnam (3.9 billion USD), and accounted for 87.7% of FDI in 2020. It is also believed to be the country’s largest bilateral aid
energy, strategy, country’s, in, Laos, projects, could, new, economic, better, should, projects, continues, Thai, Laos, Thus, attempt, might, a, in, simply, approved, the, construction, and, electricity, on, purchase, the, sources, and, availability, their, agreements, is, electricity, regarding, hydropower, several, from, times, Thailand, importer, the, Yet, in, Thailand, investor, and, of, upstream, and, excessive, of, water, levels, of, experienced, years, recent, as, severe, well, as, droughts, and, river, already, have, dependent, also, ASEAN, as, of, the, harm, with, people, millions, damages, could, caused, dams, This, prompt, and, increasingly, environmental, social, regarding, hydropower, its, Laos’, This, burden, even, and, the, Laos’, controlling, in, to, line, energy, exports, the, Laos’, like, could, deal, risks, and, implementing, the, grid, high-voltage, and, which, expand, the, company, received, 25-year, In, 2021, a, to, the, EDLT, of, Laos, du, the, Ltd, (EDLT) Électricité, Company, state-owned, Grid, Majority, which, grid, signed, relevant, USD, of, 2 billion, in, manage, the, grid, high-voltage, and, which, expand, the, company, EDLT, Export-Import, Bank, of, China. In fact, some sources estimate that more than half of Laos’ 12.6 billion USD sovereign debt is owed to the PRC, which would undoubtedly bestow Beijing with considerable influence over its southern neighbor’s affairs.

Some analysts were already concerned about Laos’ rising debt to China even prior to the Covid-19 pandemic and categorized the state as being in danger of sovereign default. However, with the emergence of the global pandemic, and the subsequent loss of revenue (particularly from the tourism sector), those concerns have been severely aggravated. Facing dwindling foreign reserves, the country is currently struggling to repay its annual debt obligations of about 1 billion USD until the end of 2024, partly resulting from the railway project. In order to avoid the risk of sovereign default, Laos sought to negotiate alternative solutions with its largest creditor, China. Therefore, in September 2020, Électricité du Laos (EDL), which manages the nation’s electrical grid, signed a shareholding agreement with the state-owned China Southern Power Grid. Majority control of the new joint venture under the name of Électricité du Laos Transmission Company Ltd. (EDLT) is held by the Chinese company. In March 2021, EDLT received a 25-year concession, allowing the company to manage and expand the nation’s high-voltage power grid, which will mostly be used for the export of electricity. EDLT will invest 2 billion USD in the expansion of relevant infrastructure, and after 25 years, operations will be transferred back to the Lao state. Thus, China will both support and profit from Laos’ plan to become the battery of Southeast Asia. This deal will likely take considerable financial pressure off of Lao PDR, as state-owned EDL had reportedly amassed an additional 8 billion USD of debt, mostly resulting from the country’s aggressive push for hydropower expansion.

However, the deal could also entail significant risks for the country, like the PRC effectively controlling Laos’ energy exports. With EDLT poised to invest in the nation’s power line network, the LPRP leadership might also struggle to see feasible alternatives to the expansion of its hydropower projects. This could raise Laos’ debt burden even higher and potentially prompt the country to increasingly disregard concerns regarding environmental and social damages caused by large hydropower dams, particularly along the Mekong river. This could also harm Laos’ relations with its ASEAN neighbors, as the livelihoods of millions of people in Thailand, Cambodia and Vietnam are dependent on the river. They have already experienced severe droughts in recent years as well as incrementally unpredictable changes of water levels and loss of biodiversity and fish stocks, believed to be the result of excessive dam construction upstream. Yet, Thailand is by far the largest investor in and importer of hydropower from Lao PDR. However, in recent times, Thailand has delayed several agreements regarding the purchase of electricity from new dam projects and is looking into buying from alternative power sources and their availability. Yet, Thailand only recently approved the purchase of electricity from new hydropower dams, and construction on the projects in Laos continues unabated. Thus, Thai authorities might simply attempt to get a better deal. However, should Thailand and the other ASEAN nations actually stop importing energy from new projects in Laos, the country’s economic development strategy could
backfire. This would leave China almost as the sole electricity customer, thus giving Beijing even greater leverage over its southern neighbor.

Additionally, some Lao officials are reportedly concerned about the lacking transfer of technology and relevant know-how following the EDLT deal. According to Radio Free Asia, a Lao Ministry of Energy and Mines expert worried that Laos would have to rely on Chinese technicians in the future in order to make repairs or changes to the infrastructure built by Chinese companies. Similar concerns also apply to the railway, which will require constant maintenance works. Therefore, Laos is at high risk of dependence on China, which might prove to be a great stress factor in the country’s future dealings with its ASEAN-peers.

The EDLT-deal and the Laos-China railway are the most recent and extremely prominent examples of increased Lao-Chinese relations. Overall, the PRC has taken center stage in Laos’ foreign relations, surpassing the country’s traditionally closest political ally Vietnam. The close relationship between Laos and China is only strengthening, as can be seen in the capital city of Vientiane, where a Chinese real estate developer is planning to erect a 100m tall Buddha statue along with hotels, apartment buildings, and various other facilities in a Special Economic Zone (SEZ). Over the past two decades, a growing number of SEZs, designated for targeted foreign investment and development, has been created in Laos, particularly clustered along the Thai and Chinese borders. However, the boost of tourism and migration, particularly from China, expected to accompany the new railway, could potentially create rising tensions among the Lao people. The sparsely populated country is already home to about 300,000 Chinese nationals and hosted more than 760,000 Chinese tourists in 2019 alone - a 26% rise from the year before. Generally, Lao tourist sites will need to develop plans to sustainably accommodate the growing number of tourists, in order to avoid overwhelming local populations and the environment. Also, as many people are still waiting to be reimbursed or have received compensation well below the market value of their properties, frustration among those who have been expropriated to make way for the railroad project is on the rise.

The growing tilt towards China can also be observed in the composition of the Lao PDR leadership. In early 2021, Laos appointed former Minister of Industry and Commerce Khemmani Pholsena to Minister of the Presidential Office of Laos. Pholsena was a former classmate of Chinese President Xi Jinping at the Beijing Bayi school. She will closely advise President Thongloun Sisoulith and is likely to become greatly involved in the dealings with China and President Xi. During an official state visit to Laos in 2017, President Xi even took the time to visit the Pholsena family. The occasion prompted Chinese news agency Xinhua to conclude that “the Pholsena family is China’s good friend and old friend.” Leveraging this unique personal connection has certainly been part of the rationale behind Pholsena’s appointment.

**How does the railway’s European counterpart compare?**

While the Laos-China railway has now been finalized, the first major BRI project in the European Union has only just kicked off. In October 2021, roughly 8 years after the initial idea had been conceived, construction began on the Hungarian section of the Budapest-Belgrade railway. Through the modernization of the existing tracks initially built in 1883, the new 350km rail will reduce travel time between both capitals from 8 to just 3.5
While construction on the 166km Hungarian section has only just begun, the 184km Serbian section - partly financed and constructed by Russian companies - is nearing completion.

Once completed, the Budapest-Belgrade railway is envisaged to be part of a larger rail network connecting western Europe with the deep sea port in Piraeus, which is mostly operated by the Chinese state-owned China Ocean Shipping Company, and is supposed to function as Asia’s main maritime gateway for cargo shipping to Europe. Therefore, much like Laos, Hungary seeks to become a transit hub and hopes to profit from the increased international flow of trade and goods through the country. In order to do so, the state took on Chinese loans of more than 2 billion USD in 2020. However, as opposed to the Laos-China railway, the Budapest-Belgrade railroad, and the Hungarian section in particular, has been plagued by delays and allegations of corruption since the beginning. It did not help to ease suspicions when the government in Budapest decided to classify official documents related to the rail project’s financing.

**Global Infrastructure Competition**

Overall, the European perception of BRI-related large-scale infrastructure projects has greatly changed since the idea of the Budapest-Belgrade railway was originally developed within the 16+1 format. Some central and eastern European states among the 16+1, such as Lithuania, have been left disenchanted as their high expectations of BRI investments have not been met so far, and promises of the development of tangible projects have yet to be followed up on. Others, such as Montenegro are facing exponentially increasing project costs and slow progression due in large part to alleged internal corruption. Even though the country’s problems have not been caused by China, questions have been raised regarding the viability and potential long-term repercussions of such projects, presenting great risks, particularly for countries with small economies such as Montenegro or Laos. In this regard, the Budapest-Belgrade railway’s eventual completion in 2025 will likely come too late to meaningfully change the current narrative, particularly amid rising tensions between China and the EU, and the US-China trade war.

In this context, the EU’s recently proposed Global Gateway initiative could become an important instrument in the future. Designed to present an alternative to the Chinese BRI, it is supposed “to create strong and sustainable links, not dependencies,” as EU Commissioner for International Partnerships, Jutta Urpilainen, put it. The planned 300 billion EUR infrastructure and connectivity investment program appears to be focused mainly on the EU’s neighborhood, particularly the Western Balkans, Central Asia and Africa, but also on the Indo-Pacific, in line with the bloc’s respective strategy paper for regional cooperation. By stating that “Global Gateway and the US initiative Build Back Better World [B3W] will mutually reinforce each other,” the EU clearly aligns itself with the United States in an effort to counterweight the BRI. However, it remains to be seen how effective the EU’s initiative will ultimately be, but it clearly signals the EU’s intent to pursue a more active and visible foreign action, not in the least in the Indo-Pacific.

Even though Global Gateway and B3W were imagined in opposition to the BRI, the best case scenario is for them to complement each other. In fact, those initiatives harbor great synergetic potential, since China, the EU and the US will ultimately all benefit from enhanced
connectivity resulting from the respective others’ initiatives. Therefore, the EU will likely benefit from a railway connection between the port of Piraeus and western European economies. The same goes for enhanced connectivity in Laos. In 2020, the EU was Laos’ fourth largest trade partner and it stands to reason that bilateral trade will increase as a result of the country’s improved linkages to global and regional supply chains. In fact, the EU’s Indo-Pacific strategy specifically emphasized the blocs ambition to cooperate with ASEAN and its members for example in fostering connectivity. Therefore, the EU should follow up on its self-proclaimed objectives and launch its own initiatives in Laos, for example in the areas of digitalization and green growth, and in alignment with its Indo-Pacific Strategy and Global Gateway Initiative. The EU could offer its assistance regarding the sustainable development of the economic corridor along the railroad and potentially invest in promising businesses, thus harnessing the nation’s improved connectivity, while strengthening EU-Lao relations. Doing so could also serve to slowly decrease Laos’ dependence on China, even though this would certainly require substantial investments in the country.

Overall, the incipient global infrastructure competition harbors great potential for all parties involved, including the developing world. However, the mere construction of such large-scale endeavors will not be sufficient, as they also entail considerable risks, particularly for states with smaller economies such as Lao PDR. Yet, if it implements relevant reforms and makes necessary investments, the nation of Laos and its people will certainly profit from the newly built railway. Parallel investments for example in road infrastructure convey a positive outlook. In addition to economic gains through increased international trade, investment and tourism, the country will thus also benefit from improved and more secure domestic connectivity. Furthermore, as part of a potential Pan-Asia railway, this could also serve to intensify regional integration within ASEAN.

The railway represents an important step towards bringing one of the poorest nations of Southeast Asia up to speed with its ASEAN counterparts. However, all this may come at the cost of greater dependence on China. Therefore it remains to be seen to what extent Laos will be able to pursue an independent foreign policy in the future and how the railway will ultimately benefit the country and its people.

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