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CHINA AND THE WEST COMPETING OVER INFRASTRUCTURE IN SOUTHEAST ASIA

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EXECUTIVE SUMMARY

The U.S. and China are promoting competing economic programs in Southeast Asia. China's Belt and Road Initiative (BRI) lends money to developing countries to construct infrastructure, mostly in transport and power. The initiative is generally popular in the developing world, where almost all countries face infrastructure deficiencies. As of April 2019, 125 countries had signed onto BRI including all 10 ASEAN countries.

One valid criticism of BRI is that the program lacks transparency, so it is difficult to find details on how much China is lending for different projects, what the terms of the loans are, and what environmental and social risks are involved. While the advanced economies have generally been critical of the initiative, Italy broke ranks with the rest of the G-7 and signed up for BRI in 2019.

U.S. opposition to China's initiative is crystalized in the Trump administration's Free and Open Indo-Pacific (FOIP) program, which criticizes Beijing for leveraging predatory economics to coerce other nations and poses a clear choice between "free" and "repressive" visions of world order in the Indo-Pacific region. While the U.S. initiative criticizes China's lending, it does not offer ASEAN countries much in the way of alternative financing as Western aid has declined and shifted away from infrastructure.

Concerning ASEAN's borrowing from China, the projects are diverse: international rail, urban transport, expressways, hydropower, carbon-based power, transmission lines. Among the major borrowing countries, some are authoritarian, whereas others are more democratic.

The large countries in ASEAN were in good financial shape prior to the coronavirus crisis, so fears of "debt-trap diplomacy" were over-blown. The smaller economies — Laos especially — were more at risk. It is likely that the coronavirus will lead to public health crises in many developing countries, including in ASEAN. What is even more certain is that the global recession will hit these countries hard. Volumes and prices of the primary products that many developing countries export are down substantially. The G-20 has endorsed the idea of a debt moratorium on payments by low-income countries. There are many examples of China restructuring or writing off debts since 2000, so it is realistic to expect China to participate in a new round of rescheduling and write-offs. While China and the West have been competing over infrastructure in Southeast Asia, coordinating on debt relief will now be an important area for cooperation.

Finally, there is some initial evidence that China is learning from its experience and improving its practices. Recommendations for the U.S. include dialing down the anti-China rhetoric and joining AIIB, supporting additional human and financial resources for the International Monetary Fund (IMF), encouraging the World Bank to focus more on infrastructure and to reduce processing times for its loans, and increasing cooperation with longstanding partners, such as Japan, Australia, and Singapore, to support sustainable infrastructure development in Southeast Asia.

INTRODUCTION

The U.S. and China are promoting competing economic programs in Southeast Asia. China got in first, when President Xi Jinping of China proposed the Belt and Road Initiative (BRI) in a pair of speeches in 2013. In Kazakhstan, he outlined a vision of restoring overland trade routes from China to Central Asia and Europe — the ancient "Silk Road." In Indonesia, he introduced the concept of a "Maritime Silk Road," which is essentially the already well-traveled sea corridor south from China through the South China Sea and the Indian Ocean, on to the Middle East and Europe. While part of the Chinese effort on BRI is aimed at these specific corridors, the program is in fact global and not directed at any specific geography. Latin America is deeply involved, as are all parts of Africa. The main objective is for China to lend money to developing countries to construct infrastructure in transport, power, water supply, and other sectors. In his opening remarks at the Belt and Road Forum in Beijing in May 2017, President Xi noted that:

> Infrastructure connectivity is the foundation of development through cooperation. We should promote land, maritime, air and cyberspace connectivity, concentrate our efforts on key passageways, cities and projects and connect networks of highways, railways and sea ports…We need to seize opportunities presented by the new round of change in energy mix and the revolution in energy technologies to develop global energy interconnection and achieve green and low-carbon development. We should improve trans-regional logistics network and promote connectivity of policies, rules and standards so as to provide institutional safeguards for enhancing connectivity.[1]

The initiative is generally popular in the developing world, where almost all countries face infrastructure deficiencies. According to the Chinese government, 125 countries have signed onto the BRI as of April 2019, including all 10 ASEAN countries.

While the initiative is popular with developing countries, it has received various criticisms from the leaders of advanced industrial economies. One valid criticism is that the program lacks transparency, so it is difficult to find details on how much China is lending for different projects, what the terms of the loans are, how contractors were chosen, and what environmental and social risks are involved. Horn, Reinhart, and Trebesch find that much of China's overseas lending does not appear in the World Bank and International Monetary Fund (IMF) data for sovereign debt.[2] BRI has also been criticized as an effort to export China's authoritarian model, as a number of major loan recipients have poor records of democracy and civil liberties (e.g., Venezuela in Latin America, Cambodia and Laos in Asia, and Sudan and Zimbabwe in Africa). While the advanced economies have generally been critical of the initiative, Italy broke ranks with the rest of the G-7 and signed up for BRI in 2019.

BRI has also been criticized as an effort to export China's authoritarian model, as a number of major loan recipients have poor records of democracy and civil liberties

U.S. opposition to China's initiative is crystalized in the Trump administration's Free and Open Indo-Pacific (FOIP) program. According to Stromseth, "FOIP singles out China for pursuing regional hegemony, says Beijing is leveraging 'predatory economics' to coerce other nations, and poses a clear choice between 'free' and 'repressive' visions of world order in the Indo-Pacific region."[3]

The objective of this paper is to examine the competing U.S. and Chinese initiatives in the area of infrastructure in Southeast Asia in light of available information and to combat common misconceptions and unsubstantiated rhetoric. The next section focuses on infrastructure needs and the existing track record of Western assistance. The third section of the paper then focuses on the implementation of China's BRI in ASEAN countries. The fourth section concludes.

INFRASTRUCTURE NEEDS AND WESTERN ASSISTANCE

Investing in infrastructure is a crucial aspect of a successful growth strategy. McKinsey takes stock of infrastructure investment in all countries of the world and concludes that there is a significant gap between what countries are spending and their infrastructure requirements if they are to continue to grow well until 2035.[4] Emerging Asia, excluding China and India — which would mostly be ASEAN — could productively spend $300 billion per year on infrastructure. The big-ticket items are transport and power, with significant needs in water supply and sanitation as well. Most of these resources need to come from domestic savings, and many countries are already investing significantly in infrastructure. Indonesia, for example, is implementing 75% of the needed investment. But on the other hand, that means that 25% of infrastructure requirements go unmet. In general, the developing world will have to finance or attract more infrastructure investment if it is to meet its growth objectives.

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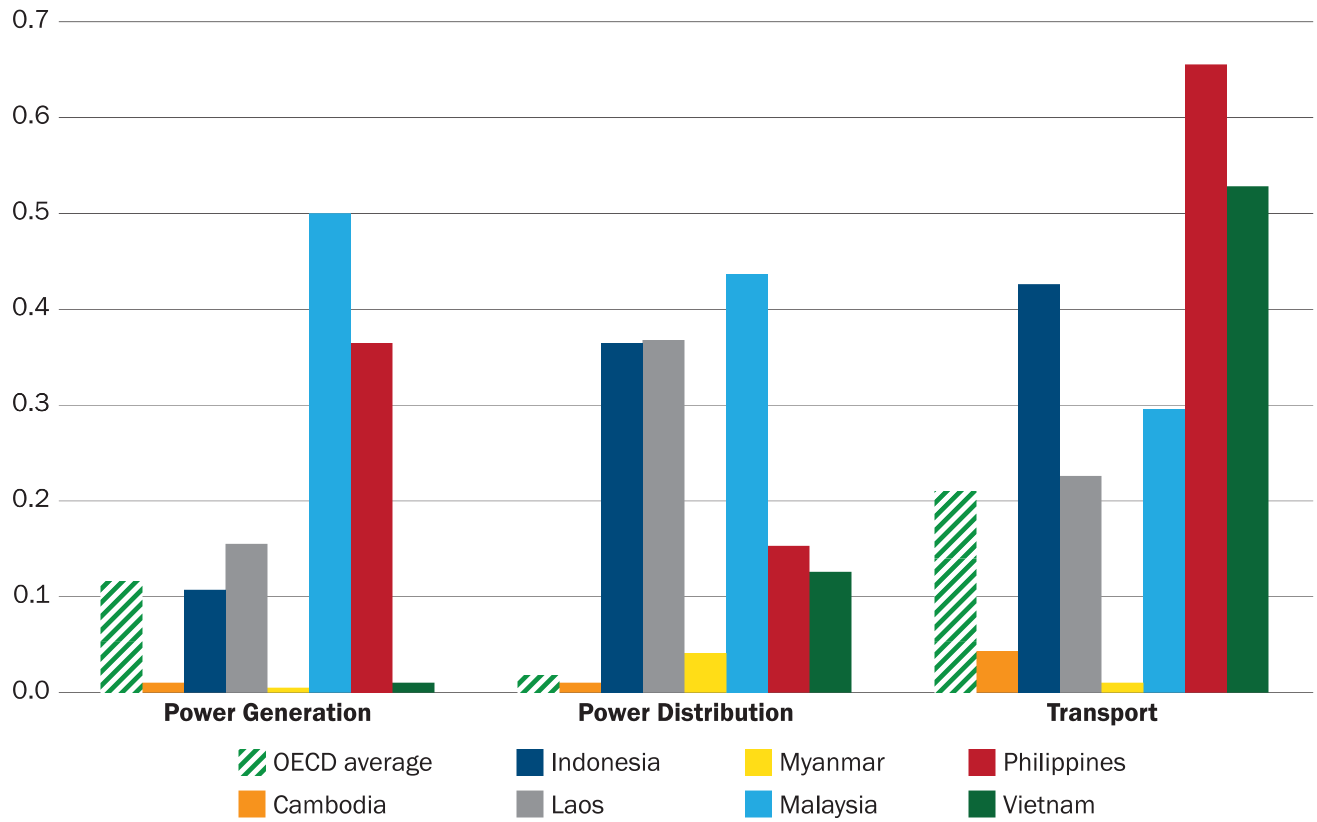
Traditionally, ASEAN countries could rely on Western support — through bilateral financing and the multilateral development banks — to finance some of their infrastructure investment. However, that is no longer the case. Japan is the only significant financier of infrastructure remaining. During 2015-2017, Japan committed $13 billion to transport and energy infrastructure in ASEAN countries. No other Western donor reached $1 billion per year. The total from the six major Western sources — Australia, Japan, Asian Development Bank (ADB), World Bank, United States, and South Korea — amounted to about 2% of infrastructure financing needs for the ASEAN countries.[5] Two things are going on here. First, the overall amount of Western aid is not keeping up with needs. Second, the donors are generally turning away from infrastructure. When initially set up, 70% of World Bank financing went to infrastructure. During 2015-2017, only 29% of World Bank support to ASEAN went to infrastructure. The figure for ADB was only slightly better at 39%.

The multilateral development banks have tied themselves up in complicated environmental and social safeguards such that doing large infrastructure projects with them is time-consuming and expensive.[6] The result is that little infrastructure is financed.

The U.S.-led FOIP program initially had little economic content and focused more on security issues. However, this changed with the Better Utilization of Investment Leading to Development (BUILD) Act, signed into law in October 2018, which establishes a new U.S. International Development Finance Corporation and doubles U.S. development finance capacity to $60 billion worldwide. Additionally, the U.S. Overseas Private Investment Corporation (OPIC) signed a Memorandum of Understanding (MOU) with the development finance agencies of Japan and Australia to "catalyze Indo-Pacific investment projects that produce quality infrastructure, increase connectivity, and promote sustainable economic growth."[7] The three countries have picked a $1 billion liquified natural gas project in Papua New Guinea as their first case for joint financing under the MOU. They plan to abide by the Group of 20 (G-20) principles for "quality infrastructure investment," adopted at the G-20 summit in Osaka in June 2019, and sent a joint delegation to Indonesia in August to explore other potential projects.

Another aspect of declining Western support for infrastructure is the ideological view that infrastructure can be left to private investment. This is certainly true in telecom, but in transport and power it has proved hard to attract private investment. Partly the problem is regulatory restrictions in developing countries. The OECD calculates an FDI restrictiveness index for different sectors. In transport and power generation and distribution, ASEAN countries tend to be more restrictive than OECD countries. However, countries

FDI restrictiveness index for power generation, power distribution, and transport, 2018 (0=Open; 1=Closed)



Source: OECD FDI Restrictiveness Index[8]

that are very open such as Cambodia or Myanmar still struggle to attract private participation in infrastructure. This is an area where countries need capacity building support in order to intelligently open their sectors and to manage the complex contracts that are typical in infrastructure.

CHINA'S INFRASTRUCTURE FINANCING IN SOUTHEAST ASIA

It is difficult to say how much Chinese financing is going to infrastructure in Southeast Asia because the Chinese effort lacks transparency. China's loans are largely coming from the two policy banks: China Development Bank and China EXIM Bank. They borrow on domestic and international capital markets and lend with a spread, so they expect to be financially self-sufficient. EXIM has access to some subsidies from the Ministry of Finance so that some of its lending can be concessional. The motivation for China is partly economic; the economy has excess savings and under-employed construction companies and heavy industry. The projects are a way to put these resources to use. Also, if infrastructure is improved in developing countries, then China — as well as other countries — will benefit indirectly as trade expands. A 2019 World Bank study estimates that there would be very significant gains to the recipient countries from the transport projects in BRI, as well as spillover benefits to China and the rest of the world. The study also notes that in many countries, poor policies are more of an impediment than poor infrastructure.[9] There is also strategic motivation as China gains friends and influence through these projects. A further strategic consideration is that China would like to have alternate routes to transport natural resources, routes that are not controlled by the United States and its allies.

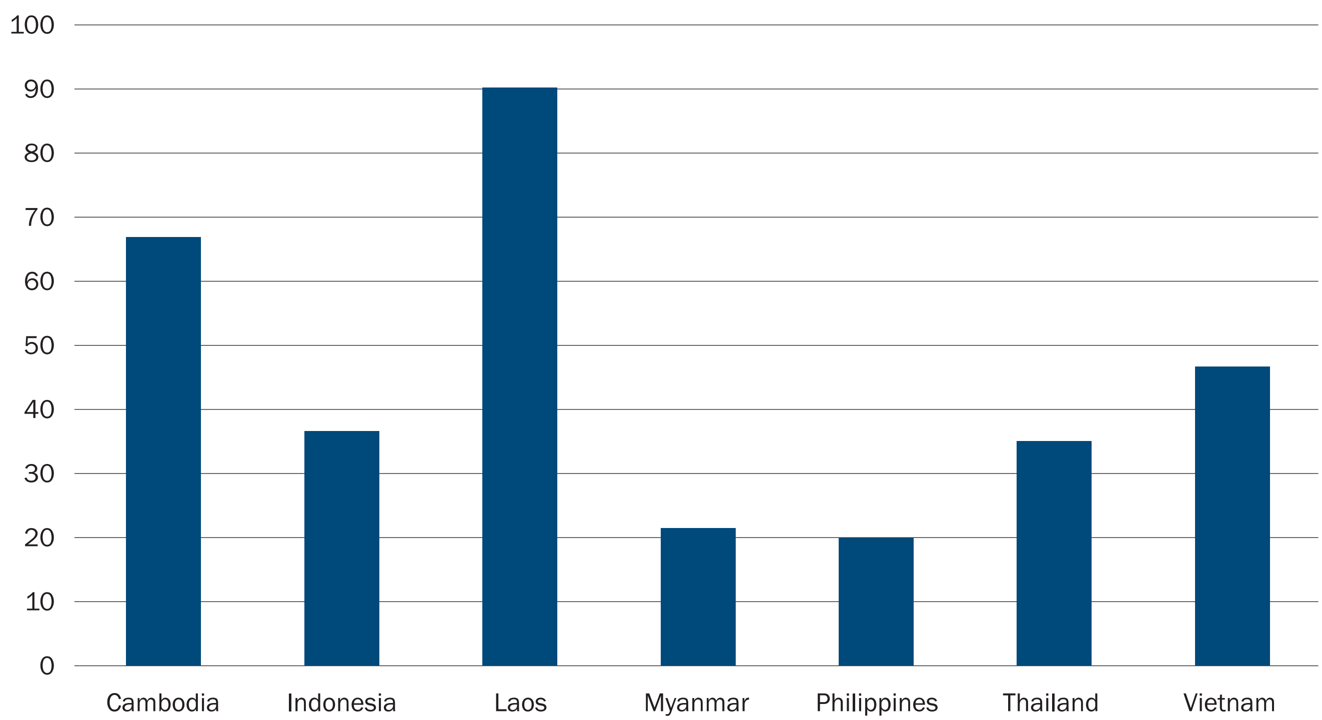
While it is hard to get reliable data on Chinese lending for infrastructure, an academic exercise under the name AidData has put together estimates of Chinese lending to different countries and sectors through 2014.[10] Working with those data, I showed that China's lending was indiscriminate in terms of geography and governance. That is, the lending is not aimed at the BRI corridors but rather is a global endeavor, and the countries receiving loans have very different governance.[11] Three of the top 20 borrowers according to these data were ASEAN countries: Cambodia, Indonesia, and Laos. They illustrated the point about governance as Indonesia is a democratic country, whereas Cambodia and Laos are authoritarian. Based on the amounts lent to those three countries, it seems likely that China's lending is of the same scale as Japan's lending.

Table 1 lists major projects in ASEAN countries undertaken with Chinese financing since 2015. The list is not exhaustive and has been developed from press reports. The projects include coal-fired power in Indonesia and hydro in Laos. Major transport projects involve rail in Malaysia, Laos, and Indonesia, and road expansion in Cambodia, Laos, and Indonesia. Most of the loans are on commercial terms, in dollars at flexible interest rates. Some are concessional, such as the loan to Cambodia for urban roads.

Debt sustainability is a concern for these smaller economies, but not a big issue for the large economies of ASEAN, which can afford to take on more debt.

Since China's money is mostly not concessional, it has been accused of "debt trap diplomacy" — that is, of saddling countries with high-interest debt that they are unable to repay, giving China leverage over the borrowing country. External debt is different from domestic debt in that it ultimately has to be serviced by exports, so there is a limit to how much debt a country can take on without putting itself at risk of a financial and balance of payments crisis. In a speech in May 2019, Secretary of State Mike Pompeo criticized China for peddling "corrupt infrastructure deals in exchange for political influence," and using "bribe-fueled debt-trap diplomacy" to undermine good governance.[12]

External debt, 2018 (% of GNI)



Source: World Development Indicators[13]

Looking at the data on external debt relative to GNI for ASEAN countries, most of them are in very good financial shape as of 2018, so that debt sustainability is not much of a worry. The exceptions are Laos, with external debt at 90% of GNI, and, to a lesser extent, Cambodia (68%). Hurley, Morris, and Portelance assess the likelihood of debt problems in 68 countries along the land and maritime transport corridors. They find that 8 out of 68 countries are at risk of debt distress because of borrowing from China, including Laos. They do not see Cambodia having severe risk yet, but its external debt has risen rapidly.[14] Their analysis takes account of future planned projects so that they can look at the trajectory of external debt over the next few years. Hence, debt sustainability is a concern for these smaller economies, but not a big issue for the large economies of ASEAN, which can afford to take on more debt.

To summarize the debt issues for ASEAN countries: Laos highlights the risk of taking on too much debt too quickly, especially non-concessional debt. In its most recent consultation with the IMF, Laos authorities agreed to a moratorium on new infrastructure investment projects.[15] A key role for the IMF is to help developing countries in this situation with advice and financing. If Laos holds off on new projects while it digests the existing pipeline, then it can avoid a debt crisis. The other countries of ASEAN are not at risk of debt distress. An important caveat, however, is that not all Chinese lending may be included in the standard data for external debt, as China is not transparent enough about its lending.

While most of China's lending has come from CDB and EXIM, an interesting new development is the Asian Infrastructure Investment Bank (AIIB), launched by China, headquartered in Beijing, and now with 100+ members. Around the time of the Global Financial Crisis, an international commission under the chairmanship of Ernesto Zedillo examined the performance of the World Bank and the other multilateral development banks (MDBs) and made recommendations for modernizing them.[16] This commission had good representation from the developing world (including Zhou Xiaochuan from China) and made a series of practical recommendations: increase the voting shares of developing countries to reflect their growing weight in the world economy, abolish the resident board as an expensive anachronism given modern technology, increase the lending capacity of the MDBs to meet growing developing world needs, re-establish the focus on infrastructure and growth, and streamline the implementation of environmental and social safeguards in order to speed up project implementation.

China generally shared these criticisms of the MDBs. In the wake of the Zedillo report, however, there was no meaningful reform. This frustration with lack of reform in the World Bank, combined with a general dissatisfaction with the U.S.-led global financial system, influenced China to launch the new development bank. Alex He notes: "Indeed, China and other emerging powers have criticized the World Bank and the IMF for their inefficient and over-supervised processes of granting loans. The current gap between the demands for infrastructure investment and available investment from existing international financing organizations in developing countries creates an opportunity for emerging economies to establish a new type of bank with a directed focus in this area."[17]

The charter of the AIIB follows very much in the spirit of the charters of the World Bank and ADB, but also incorporates virtually all of the Zedillo report recommendations: majority ownership by the developing world, no resident board, authority to lend more from a given capital base, a focus on infrastructure and growth, and environmental and social guidelines that should be implemented in proportion to the risk.[18]

The AIIB approved its first project in June 2016. In the three years since, it has approved 46 projects for a total of $8.5 billion in financing. The projects, listed on its website, are diverse in terms of countries and sectors. Projects in ASEAN include Indonesia slum upgrading, Philippines flood management, and Laos road improvement, to name a few. While the AIIB portfolio covers a diverse group of countries, not surprisingly the largest borrowers tend to be the largest economies in Asia. India is by far the largest borrower, with 27% of the $8.5 billion lent so far. Other large borrowers are Indonesia (11%), Turkey (11%), Bangladesh (7%) and Pakistan (5%).

CONCLUSIONS AND RECOMMENDATIONS

One of the main objectives of this paper is to make the ASEAN experience with BRI infrastructure projects more real: What infrastructure are these projects building? Which countries are the main borrowers? What are the terms of the loans and how do they fit into the overall government debt management? Are we likely to see a slew of debt crises? Are the countries supported mostly authoritarian ones? Do the borrowing countries have the necessary supporting technologies to connect to global markets? How does the Chinese effort interact with the U.S.-led Free and Open Indo-Pacific initiative?

The large countries in ASEAN were in good financial shape prior to the coronavirus crisis, so fears of "debt-trap diplomacy" were over-blown.

These are difficult questions to answer definitively, but experience and data are on the increase. The most striking result from this review is the *heterogeneity* of experiences among ASEAN countries. The projects are mostly in transport and power, but are nevertheless diverse: international rail, urban transport, expressways, hydropower, carbon-based power, transmission lines — to name just some. The major borrowing countries are spread out over the world and not confined to the geography of the "Silk Road Economic Belt" and "Maritime Silk Road" as originally laid out by Xi Jinping. Some of these are authoritarian countries, whereas others are more democratic.

The large countries in ASEAN were in good financial shape prior to the coronavirus crisis, so fears of "debt-trap diplomacy" were over-blown. The smaller economies — Laos especially — were more at risk. Most worrisome are the loans that are at commercial, flexible interest rates. It is likely that the coronavirus will lead to public health crises in many developing countries, including those in ASEAN. What is even more certain is that the global recession will hit these countries hard. Prices for the primary products that many developing countries export are down substantially, and trade volumes are way off. So, countries will not be able to earn the resources they need to service their debts. The G-20 has endorsed the idea of a debt moratorium on payments by low-income countries. Horn, Reinhart, and Trebesch find at least 140 instances of China restructuring or writing off debts since 2000.[19] So, it is realistic to expect China to participate in a new round of rescheduling and write-offs. While China and the West have been competing over infrastructure in Southeast Asia, coordinating on debt relief will now be an important area for cooperation.

Finally, I would argue that there is some initial evidence that China is learning from its experience and improving its practices. In the early days of Chinese lending to the developing world, Chinese institutions showed little concern for debt sustainability issues. Now the Chinese lending is often captured in IMF programs that have overall borrowing ceilings and that should ensure sustainable build-up of debt. In the case of Malaysia, the major rail project was redesigned and scaled down after a new government came to power and requested changes, an example of pragmatism on the part of the Chinese partners. Russell and Berger similarly find pragmatic adaptation on the part of the Chinese in their Southeast Asian projects.[20]

These results also have implications for how the United States and its Western allies should respond to BRI:

- Dial down the anti-China rhetoric and join AIIB (United States, Japan). U.S. accusations of China's "debt-trap diplomacy" do not resonate with much of the developing world and make the United States seem insecure. AIIB is transparent and multilateral and the United States and Japan should be encouraging the expansion of this effort, as an alternative to Chinese bilateral financing. Joining AIIB would show that the United States and Japan are not simply opposing all Chinese external efforts and would give more credence to Western criticisms of China's bilateral programs.

- Support additional human and financial resources for the IMF as this is the institution that is best placed to help developing countries manage their external borrowing and to integrate Chinese projects into their budget management and development strategies. The world tends to underinvest in the IMF during boom times, leaving it under-resourced when crises hit. The worldwide recession in the wake of the coronavirus will probably usher in a new round of developing country financial crises and the IMF will need to take the lead in limiting the financial and economic toll.

- Encourage the World Bank to focus more on infrastructure and to reduce processing times for its loans, giving developing countries competitive alternatives. This would require the bank to rely more on the environmental and social safeguards that developing countries themselves have in place, rather than creating an expensive super-structure to micro-manage projects. Without more risk-taking it is hard to see how the traditional institutions can compete with Chinese banks or countries' own financing.

- Increase cooperation with longstanding partners, such as Japan, Australia, and Singapore, to support sustainable infrastructure development in Southeast Asia. This should include a focus on capacity building, especially to manage infrastructure projects, both from private investors and from Chinese lenders.

Table 1: Some major infrastructure projects funded by China, 2015-present

Country	Loan (USD Millions)	Financier	Year	Sector	Project	Details
Cambodia	$351	EXIM	2018	Transport	—	The concessional loan agreement was signed on July 10 between the Export-Import Bank of China and Cambodia's Ministry of Finance to build a four-lane, 47-kilometre city ring road.
Indonesia	$125	AIIB	2017	Multi-Sector	Dam Operational Improvement and Safety Project Phase II	The Project Objectives are to increase the safety and functionality of existing dams in selected locations and strengthen the operation and management capacity for dam safety.
Indonesia	$270	China EXIM Bank; Industrial and Commercial Bank of China (ICBC)	2016	Energy	Coal-fired plant in Bengkulu	China-invested power plant starts construction in Indonesia to resolve electricity shortage.
Indonesia	$3,000	China Development Bank (CDB)	2016	Infrastructure	Infrastructure Construction	China Development Bank has issued $3 billion 10-year loans to three Indonisian banks (Bank Negara Indonesia, Bank Rakyat Indonesia and Bank Mandiri) for infrastructure construction in the Southeast Asian country.
Indonesia	$4,500	CDB	2015	Transport	Jakarta-Bandung High-Speed Rail	The Jakarta-Bandung high-speed railway will span 142 kilometers (88 miles) when complete, and is expected to cut the journey between the two cities from the current three to five hours down to 45 minutes.
Laos	$40	AIIB	2019	Transport	National Road 13 Improvement and Maintenance Project	This is AIIB's first approved project in Lao PDR, 58 kilometers of road will be rehabilitated in order to improve functionality, safety and climate resilience.
Laos	$600	EXIM	2016	Energy	Nam Ngum 4 Hydroelectric Power Project	The project will maximise the efficiency of the Nam Ngum River's hydropower cascade development and boost national foreign exchange reserves.
Laos	The cost of the project is estimated at $5.95 billion, of which 12 percent are financed by Laos directly, 28 percent by China and the remaining 60 percent by loans from Chinese banks.	—	2015	Transport	Vientane-Boten Railway	The 414-km China-Laos Railway runs from Boten, the northern Lao town bordering the south-western Chinese province of Yunnan, to Vientiane, capital of Laos, with an operating speed of 160km/h. The electrified passenger and cargo railway, on which construction started in December 2016 with the full application of Chinese management and technical standards, is scheduled to be completed and open to traffic in December 2021.
Malaysia	85% of the total cost (~$8bn)	EXIM	2016	Transport	East Coast Railway Link	The rail link is meant to connect much of Peninsular Malaysia's eastern coast, whose economy lags the wealthier western coast, to a major port near Kuala Lumpur. The project was suspended due to the ballooned cost, but was resumed in April 2019 as China Communications Construction Co. and Malaysia Rail Link Sdn signed a supplementary agreement for the reduced cost.
Myanmar	$20	Asian Infrastructure Investment Bank (AIIB)	2016	Energy	Myingyan 225 MW Combined Cycle Gas Turbine (CCGT) Power Plant Project, Myanmar	The AIIB is providing US$270 million of debt financing for the development, construction, and operation of a greenfield 225 MW Combined Cycle Gas Turbine (CCGT) power plant in the Mandalay region of Myanmar.

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