

## **Part II**

# **Changes in Economy and Security with the Advent of the Belt and Road Initiative**



## *Chapter 5*

# **Australian Infrastructure Diplomacy in the Indo-Pacific**

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Infrastructure and connectivity (I&C) has emerged as a new domain of strategic competition in the Indo-Pacific. Hitherto a minor issue on the regional agenda, it quickly rose to prominence following the launch of China's landmark Belt and Road Initiative (BRI) in 2013. In subsequent years, many other governments have launched their own I&C programs, several of which compete with the BRI. These ostensibly aim to close the range of 'infrastructure gaps' which presently inhibit both the development of regional economies and the economic integration between them. However, they also reflect competing geoeconomic visions for how the regional economic architecture should develop. Hundreds of billions of dollars of financing are now being shovelled into transport, energy and telecommunication projects across the Indo-Pacific.

Infrastructure competition has posed a vexing dilemma for Australian foreign policy. On one hand, these programs promise to channel much-needed capital and technical expertise for connectivity-enhancing infrastructure in Australia's key economic partners. On the other, there are also significant concerns regarding China's BRI, particularly in terms of governance transparency and the security implications of certain critical infrastructure projects. Splits have emerged within the policy and business communities regarding the appropriate way to engage with the BRI. The Australian government has formally backed a competing US infrastructure strategy launched in 2018, but after five years is yet to articulate a clear policy on the BRI. Present settings pose risks of policy incoherence, and the potential that Australia's stance may be interpreted as 'choosing sides' between the region's great powers.

Yet the contemporary marketplace for Indo-Pacific infrastructure extends beyond Chinese and US offerings. Many governments and regional organisations have launched I&C programs in recent years. Each offers a distinctive 'blueprint' for connectivity, with different goals, governance arrangements and institutional mechanisms. These offer many channels for fruitful Australian infrastructural diplomacy, particularly with emerging economic partners in Southeast Asia. Unfortunately, the Australian policy debate has yet to move beyond a perceived choice between Chinese and US alternatives, foreclosing considered engagement with other regional mechanisms. To escape its infrastructure dilemma, Australia should develop strategies that diversify its contributions to the

regional I&C agenda across this broader set of programs.

### **Australia's infrastructure dilemma**

Infrastructure diplomacy is a recent addition to Australia's foreign policy toolkit. While Australia has a long history of supporting infrastructure projects in neighbours (such as the Mỹ Thuận Bridge built in Vietnam in the late 1990s), these activities were traditionally considered a sub-component of its aid program. But as the deleterious economic consequences of the region's infrastructure gaps has attracted greater attention, Australia was one of many Indo-Pacific governments to launch a formal infrastructure program. In 2015, it launched the *Strategy for Australia's Aid Investments in Economic Infrastructure*, the first consolidated statement of approach on supporting infrastructure projects in the region (DFAT 2015a). The strategy recognised that as Australia's fiscal contribution to infrastructure-building (estimated at only 0.3 percent of regional needs in 2013-14) was modest, it would need to target 'transformational' projects that would benefit from Australia's unique contributions. Its priorities therefore emphasised mobilised private sector finance for projects (to multiply the impact of public expenditure), incorporating human development and gender dimensions into planning, and target infrastructure types which could increase trade flows and inter-regional connectivity.

Australia's adoption of a formal infrastructure strategy was a clear response to China's Belt and Road Initiative (BRI). Launched in 2013, the BRI aims to improve economic connectivity between China and its Eurasian and Pacific neighbours. It functions as a mobilising initiative, under which Chinese agencies (principally state-owned industrial enterprises and banks) provide loans and technical assistance for infrastructure projects in regional partners. Projects are usually negotiated on a bilateral basis between China and the host government. The BRI features both economic and strategic motives. Economically, it aims to develop China's western provinces, encourage greater trade integration with contiguous partners, employ China's massive foreign currency reserves, and provide an outlet for surplus industrial capacity. Strategically, the BRI is designed to strengthen China's political influence abroad, secure China's energy supply, improve the country's diplomatic image, and increase its economic leverage over its neighbours (Cai 2017; DFAT 2015b).

While often welcomed by developing country governments with major infrastructure needs, the BRI has elicited mixed views in Australia. Its perceived positives include the channelling of significant volumes of capital – estimated potentially as high as

\$1 trillion (Hillman 2018a) – to developmentally-important projects; and the opening of new trade and investment opportunities by improving transport and telecommunications links to key Australian economic partners (Wilson 2018). However, several concerns have been raised regarding the strategic implications of the BRI, including;

- The limited transparency and minimal governance arrangements of SOE-managed projects, which may undermined ‘good governance’ development financing (Hillman 2018b)
- The prospect of ‘debt traps’, in which small economies are unable to fiscally-sustain repayments on large infrastructure loans (Hurley *et al.* 2018)
- Security concerns surrounding several China-backed port projects with mixed civilian and military uses, such as Hambantota in Sri Lanka and Gwadar in Pakistan (Brewster 2017)
- Risks that infrastructure spending will be used to compete for geopolitical influence over small economies (AFR 2018).

The Australian government has struggled to balance these competing concerns and develop a coherent position on the BRI, and how it will interact with Australia’s own infrastructure efforts. At times messaging has been positive, including the establishment of the Australia-China One Belt One Road Initiative (a business engagement NGO) in 2016 (DFAT 2016), and official statements that Australia sees “*much merit*” and “*opportunities for collaboration*” in the BRI (ABC News 2017a). But Chinese approaches to formally establish G-to-G mechanisms for infrastructure cooperation have been consistently rebuffed for strategic reasons. These include proposals to ‘link’ the BRI with the Northern Australia Infrastructure Fund, or to sign a memorandum of understanding (MoU) on BRI cooperation with the Chinese government (*The Australian* 2017). Attitudes appears to have hardened in 2018, when then-Foreign Minister Julie Bishop publicly expressed concern that BRI investments in the Pacific Islands would be “*detrimental to [these countries’] long-term sovereignty*” (SMH 2018).

The Pacific Islands has since emerged as a particular domain of concern regarding Chinese infrastructure diplomacy. In 2016, the Australian government announced the so-called “Pacific Step-Up”, a program of upgraded diplomatic engagement with the Pacific Islands government (DFAT 2019). Infrastructure diplomacy has featured prominently. In 2019 it launched the Australian Infrastructure Financing Facility for the Pacific, an AUD 2 billion fund to support infrastructure in the region (AIFFP 2019).

While officially framed as a development initiative, many observers have argued it is in part motivated by concerns that increasing Chinese infrastructure spending in the Pacific will allow China to gain geopolitical leverage over these small economies (Bergin 2019; McGregor and Pryke 2018). Another is the risk that Chinese infrastructure may compromise the security of regional technology connections. The Coral Sea Cable – a high-speed internet cable being built between Sydney, Port Moresby and Honiara – was funded by the Australian government to ensure that Chinese telecommunications supplier Huawei did not participate in the project (SMH 2019).

By contrast to its anxieties over China's BRI, Australia has been enthusiastic about collaborating with competing US infrastructure initiatives. At the July 2018 AusMIN meeting, the Australian and US governments declared an intention to “*advance a shared infrastructure agenda*” in the Indo-Pacific (DFAT 2018a). This was the first time bilateral infrastructure cooperation appeared on the AusMIN agenda. A trilateral infrastructure cooperation MoU between Australia, the US and Japan was announced later in the month (MFA 2018). These agreements leverage recent reforms to the US development assistance program, which establish a new International Development Finance Corporation (IDFC) with an investment portfolio cap double (\$60 billion) that of its predecessor (Akhtar and Tarnoff 2018). While US-Australia statements do not explicitly reference either China or the BRI, their public framing – which emphasised transparency, sustainability, private-sector involvement, and avoiding debt-burdens – were widely understood as offering an alternative I&C model to compete with the BRI (Pryke and McGregor 2018).

This Australian position – of endorsing a *potential* and *poorly-funded* US initiative, while indirectly competing against *established* and *considerably larger* Chinese one – has proven controversial. At a political level, it is easily interpretable as Australia ‘choosing’ the US over China as an infrastructure partner, with attendant consequences for the Chinese bilateral relationship. At the economic level, it is not without risk either. A significant number of major businesses are in favour of engaging with the BRI, lest Australia is excluded from the new market opportunities in the region it is creating (de Jonge 2017; PwC 2018). In October 2018, the Victorian Government took the bold step of negotiating its own BRI MoU with China, which led to a public rebuke by the Prime Minister for not consulting with the Commonwealth prior (*The Guardian* 2018). There have also been reports of an intra-governmental split at the federal level, with the trade and economic groups supportive but the security community opposed (*ABC News* 2017b). Thus, while BRI engagement is demonstrably a strategic risk for Australia, non-engagement is an equally significant economic one.

## The Indo-Pacific infrastructure and connectivity landscape

The focus on Chinese and US initiatives in debates over Australian infrastructure diplomacy is perplexing, as there is actually a much broader set of programs. In the last few years, many governments and regional organisations have established new, or reinvigorated existing, I&C programs. Table 1 lists the eight most prominent in the Indo-Pacific today. The majority were launched since 2013, and the collective budget for those that allocate investment capital is approximately \$1.5 trillion. They can be classified into three types:

1. *National programs*, where a donor state commits financial and technical assistance to support infrastructure projects in recipients bilaterally via aid programs. China, Japan and the US have launched such initiatives. China's BRI largely uses state-owned enterprises, the US IFDC aims to leverage private capital, while Japan's PQI seeks to promote 'quality' infrastructure through its official development assistance (ODA) program.
2. *Multilateral development banks* (MDBs), which offer loans and technical assistance to projects that meet specified funding criteria. The Asian Development Bank is the region's principal MDB, presently dedicates 59 percent its loan-book to infrastructure projects<sup>1</sup>. The Asian Infrastructure Investment Bank is a recent China-initiated addition, which is the world's first MDB specifically dedicated to infrastructure financing.
3. *Regulatory dialogues*, which do not offer capital but instead focus on inter-governmental cooperation to reduce regulatory barriers to infrastructure projects. This is particularly important to cross-border projects, which require regulatory harmonisation to be 'investment-ready'. These dialogues operate within ASEAN, APEC, and the Greater Mekong Subregion.

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<sup>1</sup> Of ADB loans issued in the decade to 2017. Author's calculations, from ADB (various years).

Table 1: Comparison of I&amp;C programs in the Indo-Pacific

	Initiative	Year established	Members	Budget	Activities	Description
National programs	Belt and Road Initiative (BRI)	2013	China	No official budget, est. \$1 trillion	FDI, ODA, loans, technical assistance	State agencies support firms to invest in I&C abroad
	Partnership for Quality Infrastructure (PQI)	2015	Japan	\$200 billion	FDI, ODA, loans, technical assistance	Promote 'quality' infrastructure through the ODA program
	International Development Finance Corporation (IFDC)	2018	United States	\$60 billion	FDI, ODA, loans, technical assistance	Leverage private sector investment into I&C projects
Multilateral development banks	Asian Development Bank (ADB)	1966	67 members	\$147 billion (subscribed capital)	Loans, grants, technical assistance	Longstanding regional MDB; major I&C focus in recent years
	Asian Infrastructure Investment Bank (AIIB)	2015	68 members	\$100 billion (subscribed capital)	Loans (commercial only)	New regional MDB, with functional specialisation in I&C projects
Regulatory dialogues	Master Plan on ASEAN Connectivity (MPAC)	2010, 2016	10 ASEAN members	None	Policy reform and capacity building	Nonbinding intergovernmental planning for priority I&C projects
	Greater Mekong Subregion (GMS)	1992	Cambodia, China, Laos, Myanmar, Thailand, Vietnam	None	Policy reform and capacity building	Dialogue process to foster I&C-enabling regulatory reforms
	APEC Framework on Connectivity (AFC)	2013	21 APEC members	None	Policy reform and capacity building	Promote best-practice methods for implementation of I&C projects

Source: Wilson (2019)

A noteworthy feature of the I&C landscape is the diversity of governance models on offer. In terms of modalities, some support infrastructure by offering financial and technical support, while others instead target regulatory harmonisation. Architecturally, the national programs employ a bilateral model where projects are negotiated between donor and recipient, while the MDBs and regulatory dialogues use multilateralism to support cross-border infrastructure. On the question of public versus private entities, some largely rely on state financing (China's BRI and the MDBs), others place a high priority on leveraging private capital (US IDFC, AFC) and others mix the two models (PQI, MPAC). While all aim to close infrastructure gaps, they offer a variety of mechanisms and resources to do so. Governments in the Indo-Pacific now enjoy a



diverse, and indeed somewhat crowded, marketplace for infrastructure cooperation.

The corollary is that these programs do not pose a stark either/or choice. The diversity of governance models means none are perfect substitutes for one another. Indeed, there is scope for a mutually-beneficial division of labour, which combines their various mechanisms into complete infrastructure development packages. Clear synergies exist between those with large pools of capital (BRI, PQI, IDFC and AIIB), those with in-house technical capacity and expertise (ADB, AFC), and those which provide dialogue mechanisms to facilitate inter-governmental cooperation (GMS, MPAC). The infrastructure choice is therefore one of efficient resource allocation, not picking winners. As I&C projects require both financial and political capital to succeed, they will be best achieved through approaches that combine institutional solutions.

### **Diversifying Australia's infrastructure diplomacy**

The rich landscape of Indo-Pacific I&C programs suggests the Australian policy calculus should be considerably wider than a choice between Chinese and US offerings. The alternatives offer attractive opportunities for infrastructure diplomacy. Some align well with Australia's agenda to support a rules-based order in the Indo-Pacific, particularly given the multilateral architecture of the MDBs and regulatory dialogues. Multilateral programs are also less geopolitically-charged than the bilateral Chinese and US initiatives, and offer a way to operate in the infrastructure space without perceptions of 'choosing' between the region's great powers. That these programs have not been a focus of recent Australian foreign policy – none but the AIIB and BRI are explicitly named in the 2017 *Foreign Policy White Paper*<sup>2</sup> – is a missed opportunity. There are several steps Australia can take now to diversify its infrastructure diplomacy.

First, Australia should leverage its founding membership of the newly-established AIIB. Australia played a key role during institutional negotiations in 2015 to ensure the bank embodied international best practices for development financing (SELC 2015). As a result, the AIIB has a well-developed set of loan policies that embody international best practices for development financing, and it closely cooperates with other MDBs through information-sharing and joint-venture arrangements (Wilson 2018). Australia should make the most of these governance efforts, and its \$3.7 billion capital subscription, to use

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<sup>2</sup> Its only reference reads: "There are several regional infrastructure and economic engagement initiatives, including ones advanced by China, India and Japan." (Commonwealth of Australia 2017: 45).

the AIIB as an institutional vehicle for its infrastructure diplomacy. These efforts should focus on countries with which Australia has important economic ties, such as Indonesia, Vietnam and India. Working through the AIIB also has the benefit of engaging with a China-led infrastructure initiative whose multilateral architecture avoids some of the geopolitical issues surrounding the BRI.

Second, Australia should make infrastructure a priority area for bilateral cooperation with Japan. Though launched in May 2015, Japan's PQI had gone practically unnoticed in Australia until an MoU was signed with the Nippon Export and Investment Insurance (a state-owned insurance corporation) in November 2018 (NEXI 2018). This agreement, which enables information sharing to identify projects in the region on which Australian and Japanese companies can partner, provides an initial framework for bilateral infrastructure cooperation. However, there is scope for a broader cooperation beyond investment underwriting. Particularly opportunities exist in aid collaboration, which could be developed between AusAID and the Japan International Cooperation Agency. Given the \$200 billion of capital allocated to the PQI, and its 'good governance' alignment with Australian priorities, it offers major opportunities to scale up infrastructure diplomacy with a partner that shares Australian objectives and values.

Finally, Australia can creatively support I&C platforms via technical rather than capital contributions. While Australia's fiscal capacity to invest in infrastructure projects is limited, relevant capacity in design, construction and management means Australian service and technology companies are well-placed to contribute in non-financing roles. Economic diplomacy that promotes Australian businesses' entry into infrastructure projects – via outbound investment and services trade – would complement existing capacity building work within the aid program (DFAT 2018b). Moreover, this could fruitfully be calibrated to connect to the regulatory dialogue processes. The MPAC program offers substantial opportunities given ASEAN's importance as an Australian trade partners, and could leverage connectivity work already underway within the ASEAN-Australia Development Cooperation Program (Australian Aid 2018). Such efforts would also broaden infrastructure diplomacy into the 'business-to-business' domain, and ensure that Australia is an active participant across the full-range of I&C initiatives in the Indo-Pacific today.

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