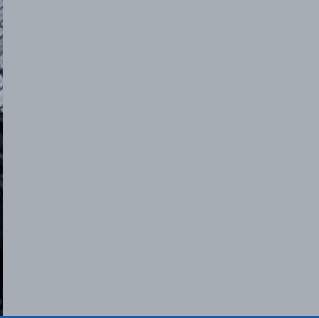


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# Connecting the Asia-Pacific: Australian participation in China's regional infrastructure initiatives

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## Executive summary

- Major ‘infrastructure gaps’ plague the Asia-Pacific region, constraining economic integration and undermining development efforts.
- In 2013, China launched two new projects – the Belt and Road Initiative (BRI) and the Asian Infrastructure Investment Bank (AIIB) – to lead regional efforts to plug these infrastructure gaps.
- These projects pose a dilemma for Australian policymakers: How to actively participate in these important efforts, while managing a range of potential governance, institutional and geopolitical risks?
- Australia should develop a coherent policy regarding engagement with Chinese-led infrastructure projects, which leverages its membership of the AIIB to manage this dilemma.
- Importantly, China’s infrastructure initiatives are qualitatively differentiated. The BRI is a semi-formal set of guidelines for developing infrastructure bilaterally; whereas the AIIB is a multilateral institution that has adopted international best practices for project governance.
- The AIIB provides a mechanism for Australia to actively participate in China’s infrastructure initiatives. The involvement of the AIIB in a project offers important ‘governance guarantees’ and can help manage perceived geopolitical risks.
- Australia should also seek to lead the institutional development of the AIIB, by offering technical and financial support to its project preparation efforts. This will have the added benefit of improving economic ties with key partners in the region, including Indonesia, India and Vietnam.

**“Australia should develop a coherent policy regarding engagement with Chinese-led infrastructure projects, which leverages its membership of the AIIB to manage governance concerns”**

## The Asia-Pacific infrastructure gap problem

For over three decades, the Asia-Pacific has been the most dynamic region of the world economy. Industrialisation, urbanisation and high-speed growth have economically transformed Asian countries and taken hundreds of millions out of poverty and into the global middle class. Importantly, the so-called ‘Asian economic miracle’<sup>1</sup> was not an individual achievement but rather a collective one, made possible by progressively deepening integration amongst the region’s economies.<sup>2</sup> This was fostered by a process of market reforms and liberalisation, deep trade and investment links developed within Asia, catalysing the growth of regional production networks in the agro-food, manufacturing and technology industries.<sup>3</sup> Regional economic integration allowed Asian economies to execute growth strategies based on attracting foreign investment and technology, upon which export-oriented manufacturing sectors were successfully established.

The Asia-Pacific now has a very well-developed *institutional infrastructure* to nurture and govern these cross-border economic ties. Two intergovernmental organisations – the Association of Southeast Asian Nations (ASEAN) and the Asia-Pacific Economic Cooperation (APEC) – function as dialogue bodies for discussion of coordinated economic policy reform. A network of regional trade agreements, based around the ASEAN Free Trade Agreement (FTA) of 1992 and its ‘6+1’ extensions negotiated in the mid-2000s, have progressively lowered tariffs and conventional trade barriers amongst regional economies.<sup>4</sup> The ASEAN+3 based Chiang Mai Initiative of 2000 and its subsequent multilateralisation provide mechanisms for financial cooperation.<sup>5</sup> Forms of deeper regulatory cooperation have also been advanced through a range of bilateral FTAs, 54 of which currently exist between Asia-Pacific economies.<sup>6</sup> While less dense than the economic arrangements of the European Union (EU), this regional architecture nonetheless provides an institutional foundation for economic integration amongst Asian countries.

Unfortunately, the *physical infrastructure* for Asia-Pacific economic integration lags far behind. Regional trade and investment links not only require regulatory frameworks, but also physical infrastructure; the cross-border road, rail, sea, aviation, telecommunications and energy connections upon which goods and services move across borders. The existence of reliable, efficient and cost-effective infrastructure is a key determinant of trade. As a recent United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) report has concluded, ‘connectivity’ contributes between 16-18 percent of trade costs in Asia; far higher than the 10 percent which can be attributed to tariff barriers.<sup>7</sup> Quality infrastructure is essential for the deepening of economic integration in the region.

As industrialisation and urbanisation have accelerated across Asia, investment in the region's infrastructural connections has failed to keep pace. This had led to the emergence of a complex array of 'infrastructure gaps', which were first identified in the Asian Development Bank's (ADB) *Infrastructure for a Seamless Asia* report of 2009.<sup>8</sup> Since this time, several quantitative estimates of the size of these infrastructure gaps have been made (Table 1). While methodological differences produce a wide range of results, the sums involved are staggering. The most recent, published by the ADB in 2017, indicates that Asia-Pacific economies will need to make US\$1.5 trillion of infrastructure investments in every year from 2016 to 2030.

**“The Asia-Pacific now has a very well-developed *institutional* infrastructure to nurture and govern these cross-border economic ties ... Unfortunately, the *physical* infrastructure for Asia-Pacific economic integration lags far behind.”**

TABLE 1

## Estimates of required infrastructure investments in Asia

Source: See Footnote 9.<sup>9</sup> All values in USD.

	Time period	Total investment needs	Total per year
<b>Asian Development Bank (2009)</b>	2010-2020	National: \$8000 billion Cross-border: \$290 billion Total: \$8290 billion	\$750 billion
<b>Multilateral Development Bank Working Group on Infrastructure (2011)</b>	2010-2020	East Asia: \$408 billion South Asia: \$191 billion Central Asia: \$13 billion Total: \$612 billion	\$56 billion
<b>Bhattacharyay (2012)</b>	2010-2020	Central Asia: \$374 billion East and Southeast Asia: \$5472 billion South Asia: \$2307 billion Pacific: \$6 billion Total: \$8159 billion	\$741 billion
<b>Asian Development Bank (2017)</b>	2016-30	Central Asia: \$492 billion East Asia: \$13781 billion South Asia: \$5477 billion Southeast Asia: \$2759 billion Pacific: \$42 billion Total: \$22512 billion	\$1503 billion



These investments in infrastructure are critically important if the momentum behind Asia's economic miracle is to be sustained. Efficient infrastructural connections are a prerequisite for international trade, which requires goods to be moved within and across countries in a timely and cost-effective manner. They facilitate foreign investment and the formation of regional production networks via the telecommunications links that are essential to manage complex and technologically-sophisticated supply chains. They also help connect 'remote' parts of Asia, especially less developed communities in rural areas that have hitherto been excluded from many of the benefits of high-speed economic growth, to regional and global markets. The need to close these infrastructure gaps is widely recognised as one of the most pressing policy problems facing Asia-Pacific economic development today.

The causes of the infrastructure gap problem are complex and challenging to solve. The problem is not, as casual inference might indicate, simply a lack of available capital. Most Asian economies have very high savings rates, and in fiscal terms have the capacity to greatly increase their level of infrastructure investment. As the ADB has concluded:<sup>10</sup>

The binding constraint for infrastructure development in Asia is not a lack of financing. On the contrary, Asia is flush with capital.

Rather, the problem is due to a range of political and policy factors that constrain both public and private investment in infrastructure projects. These constraints include:

1. lack of technical capacity to identify, design and develop infrastructure projects to the point of being 'investment ready';
2. weaknesses in the public sector that hamper its capacity to implement infrastructure projects (particularly via public-private partnership models);
3. a reliance on public sources of financing, and absence of nongovernmental financing mechanisms (such as private bond markets) which can mobilise private capital; and
4. for cross-border infrastructure, an absence of intergovernmental regulatory frameworks for coordinating policy and managing risks.

Together, these constraints have led to what is known as the *bankable projects problem*: while Asia has adequate capital to finance its infrastructure needs, there is a dearth of well-designed projects that are ready for private investment.<sup>11</sup> The solution to Asia's infrastructure gaps is not more capital, but the reform of policy and regulatory systems to ensure there is a robust pipeline of finance-ready projects.

**“The solution to Asia’s infrastructure gaps is not more capital, but the reform of policy and regulatory systems to ensure there is a robust pipeline of finance-ready projects.”**

Unfortunately, existing international institutions are not fully up to the job. Two multilateral development banks, the World Bank and the Asian Development Bank are active in the region and dedicate a significant share of their current resources toward infrastructure projects. However, neither is configured to address the root causes of the problem. The World Bank is a global institution, whose development financing mission covers a range of areas beyond infrastructure, including poverty alleviation and sustainability. For its part, in 2016 the ADB committed to spending 70 percent of its budget on infrastructure projects.<sup>12</sup> However, this translates to only US\$20 billion per year: a meagre 1.3 percent of the investment required. Furthermore, neither bank has the resources, or political remit, to engage with the regulatory reform issues that are essential for solving the bankable projects problem. As a result, many have called for the establishment of new regional institutions which can concentrate technical expertise, financial capital and political will to help close Asia’s infrastructure gaps.

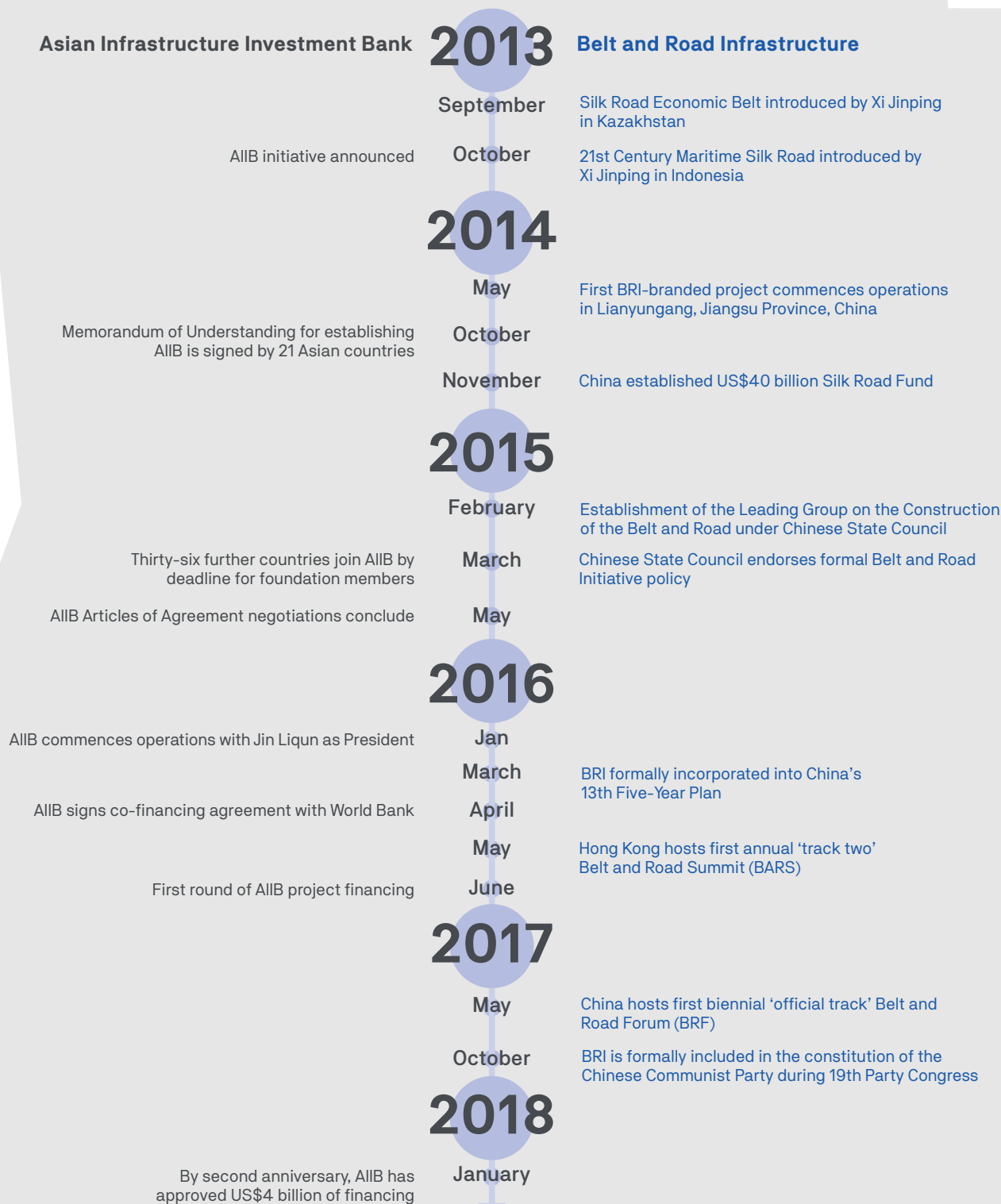
### **China’s infrastructure leadership: The BRI and AIIB initiatives**

China has taken the lead in addressing these calls. Since Xi Jinping assumed the presidency in early 2013, Chinese foreign policy has begun a transition from being an ‘institution taker’ to ‘institution maker’ in the economic space. Where China had previously been content with joining, and then seeking reform within, the existing institutions for economic cooperation, it has recently begun to build new institutions that will allow it a greater voice in global economic governance.<sup>13</sup> This agenda was accelerated following the US withdrawal from the Trans-Pacific Partnership (TPP) trade agreement in 2017. Responding to the vacuum left in the wake of the collapse of the TPP, Xi Jinping has since positioned China as an advocate for globalisation, committed to playing a leadership role in a new round of institution-building in the global economy.<sup>14</sup> A noteworthy aspect is that China’s institutional leadership efforts have been focused on infrastructure and connectivity, a policy domain that other major powers and international organisations in Asia have hitherto not prioritised.

In late 2013, the Chinese government publicly unveiled two new regionally-focused infrastructure initiatives (Figure 1). The first was the Belt and Road Initiative (BRI),<sup>15</sup> which promised to build new infrastructure platforms connecting Asia to Europe and Africa. This comprised two separate but interlinked projects: the Silk Road Economic Belt (travelling overland from China across Central Asia to Western Europe) and the 21<sup>st</sup> Century Maritime Silk Road (consisting of maritime linkages running from Southeast Asia to Africa and the Middle East). The second was the Asian Infrastructure Investment Bank (AIIB), the first multilateral development bank to be exclusively dedicated to infrastructure projects. Both were officially promoted as solutions to Asia's infrastructure gap problem, under which China would supply capital, technical expertise and political leadership to catalyse investment in new cross-border infrastructure projects. However, they were also functionally differentiated initiatives, with contrasting institutional designs.

**“China’s institutional leadership efforts have been focused on infrastructure and connectivity, a policy domain that other major powers and international organisations in Asia have hitherto not prioritised.”**

FIGURE 1  
Timeline of the BRI and AIIB initiatives



The BRI is the more ‘China-controlled’ of the two initiatives. It is best understood as an attempt to expand and cohere China’s pre-existing foreign investment efforts in the infrastructure space. Since the commencement of the ‘Going Out’ program in 2004, Chinese firms have been rapidly expanding their investments in Asia, particularly in areas of technical strength such as the construction and transport sectors. However, these efforts had tended to be piecemeal and initiated by separate agencies identifying commercial opportunities, such as the China Development Bank and the major construction and heavy industry state-owned enterprises (SOEs). Given the importance of coordination for infrastructure investment – where interconnecting road, rail and port projects need to be planned as an integrated complex – there was a perceived need to integrate these investment efforts. The BRI is a strategy to integrate and provide coherence for these investments, by focusing Chinese efforts along the two overland (‘belt’) and maritime (‘road’) corridors.

The BRI would subsequently become the flagship device for Chinese foreign economic diplomacy in Asia. The Chinese government established the US\$40 billion Silk Road Fund (SRF) in November 2014,<sup>16</sup> to functioning as a financing vehicle for BRI projects. A formal BRI policy was issued by the Chinese State Council in March 2015,<sup>17</sup> which laid out broad guidelines and priorities for investment targets, before the BRI itself was incorporated into the 13<sup>th</sup> Five-Year Plan issued in May 2016.<sup>18</sup> To foster regional interest and engagement in the initiative, two major international fora were also organised. The Belt and Road Summit, a track-two dialogue targeted at business audiences, has been held annually in Hong Kong since 2016,<sup>19</sup> while the official-track Belt and Road Forum for governments was first convened in Beijing in 2017 and is to be held biennially.<sup>20</sup> Indeed, the BRI has become so significant for Xi Jinping’s foreign policy that it was officially incorporated in the Chinese Communist Party (CCP) constitution at the 19<sup>th</sup> Party Congress in October 2017.<sup>21</sup>

The design of the BRI is defined by two key features:

1. **It is organised as a ‘guiding framework’ rather than a formal and specific plan.** There is no official set of member countries, no central Chinese agency responsible for the initiative, and no officially-designated list of BRI projects. It functions largely as a mobilising device, designed to encourage Chinese actors – principally banks, constructions SOEs and diplomatic agencies – to ensure their individual infrastructure efforts are broadly coordinated along the identified overland/belt or maritime/road corridors.

**2. It is a distinctly bilateral initiative.** The BRI collectively comprises a set of bilateral agreements for infrastructure projects. Chinese agencies work with partners in host countries to scope, plan, fund then build infrastructure on a per-project basis. There are no overarching rules for how BRI projects should be managed, which are negotiated individually and vary between cases.

These features mean the BRI has what might be labelled a ‘hub-and-spoke’ architecture, in which Chinese agencies act as the central bodies’ planning, organising and integrating regional infrastructure links. As China is typically the ‘stronger’ partner (given its economic, diplomatic and technical capacity relative to the developing countries receiving investment) its agencies have considerable – though not unlimited – capacity to set the terms of these projects.

While the AIIB shares the BRI’s agenda of closing Asia’s infrastructure gaps, its form and functions are quite different. The AIIB is a formal multilateral development bank (MDB) which specialises in funding infrastructure projects. Its establishment was rationalised by the belief that other MDBs have broad developmental mandates and therefore lack the focus and specialisation need to address the unique problems facing infrastructure financing.<sup>22</sup> By offering a bespoke MDB dedicated only to infrastructure, the AIIB is intended to consolidate technical expertise, mobilise capital, and build the political will necessary to get cross-border infrastructure projects off the ground. It also has several innovative institutional features, including a non-resident Board of Directors and a special project preparation fund designed to ensure ‘lean’ operations that can quickly move projects from the planning to construction stages.<sup>23</sup>

Chinese diplomats were incredibly successful in very quickly getting the AIIB established and operational. First mooted by Xi Jinping in late 2013,<sup>24</sup> within only a year a Memorandum of Understanding (MoU) had been signed to establish the new bank. By the time negotiation of its Articles of Agreement were completed in May 2015, some 57 countries had joined and collectively pledged US\$100 billion of subscribed capital. Significantly, the foundation members included many Western countries, such as Australia, Germany, France, and the United Kingdom, who joined despite concerted lobbying efforts by the US to stay on the sidelines.<sup>25</sup> The AIIB began operations in January 2016, started making loans six months later, and by the end of 2017 had disbursed US\$4 billion to 23 infrastructure projects across the region (Table 3).

The rapid and successful start-up of the AIIB marks one of China's first major contributions as an institution-builder in global economic governance:<sup>26</sup>

- Its US\$100 billion of subscribed capital makes it the fourth largest MDB in existence, behind the World Bank (US\$263 billion), the Inter-American Development Bank (US\$157 billion) and the Asian Development Bank (US\$147 billion).
- It is the only MDB to specialise in infrastructure, and not include broader development goals such as poverty alleviation in its mandate.
- It is the first new economic body established in Asia since the 2005 East Asia Summit, and the first financial body since the ADB in 1966.
- It is the first time China has proposed, led the negotiations for, and secured both the presidency and headquarters of a formal international organisation of any kind.

As a multilateral international organisation, the architecture of the AIIB is quite different to that of the BRI. It is a treaty-based body with 63 signatories; and has a tripartite governance structure comprising a Board of Governors (representing all members), a 12-person Board of Directors (responsible for policies and loan decisions) and a full-time management team (which coordinates operations). It has an extensive range of policies regulating its loan activities, which set principles and rules for how it selects infrastructure projects to be funded, and how such projects should be governed during construction and operation. It has also negotiated Memoranda of Understanding (MoUs) with the other MDBs, including the World Bank and ADB, that facilitate policy coordination and joint ventures with its peers. Most importantly, China does not monopolise or control the AIIB. It currently holds the presidency and headquarters, and is the largest shareholder (with 26 percent of the voting stock). However, all policy, procedural and investment decisions are made by the collective membership through the Board of Governors and Directors.

TABLE 2  
Key features of BRI and AIIB

	Belt and Road Initiative	Asian Infrastructure Investment Bank
<b>Capitalisation</b>	US\$40 billion in Silk Road Fund, plus additional financing from Chinese state-owned banks	US\$100 billion
<b>Architecture</b>	Bilateral or minilateral, on per-project basis	Multilateral
<b>Membership</b>	Informal, approximately 65 involved countries	Treaty-based, 63 current members
<b>Legal instruments</b>	Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road (State Council of the People's Republic of China (PRC), March 2015)	Articles of Agreement of the Asian Infrastructure Investment Bank (international treaty, May 2015)
<b>Leadership</b>	Belt and Road Leading Group (State Council PRC)	Board of Governors, Board of Directors, Elected President
<b>Relationship to other institutions</b>	None	MoUs with World Bank, ADB, European Investment Bank (EIB), European Bank for Reconstruction and development (EBRD)
<b>Governance mechanisms</b>	Negotiated on a per-project basis between Chinese and host country agencies	Formal policies covering operations, procurement, loan pricing, transparency, environment and social, risk management and anti-corruption



**“By making infrastructure the centrepiece of its foreign economic policy, China is signalling its intention to work with partners – bilaterally through the BRI, and multilaterally through the AIIB – to help close infrastructure gaps.”**

In this way, the BRI and AIIB are related, but clearly distinct and functionally differentiated, institutions. The BRI is a broad mobilising initiative under which Chinese agencies are encouraged to develop and invest in regional infrastructure, with governance arrangements negotiated bilaterally with host country partners on a case-by-case basis. The AIIB is an official intergovernmental bank which makes loans to infrastructure projects under a formal policy framework and with multilateral governance oversight. The BRI offers a Chinese-controlled bilateral model, while the AIIB is a regionally-controlled multilateral

institution. While both Chinese initiatives share the common aim of helping to close regional infrastructure gaps, they offer two different governance models to solve the same problem.

### **Australia’s infrastructure policy dilemma**

China’s BRI and AIIB projects promise to radically transform infrastructure connectivity in Asia. Economically, they will directly add US\$140 billion to the regional infrastructure funding pool, in addition to further loans from Chinese banks which will indirectly be mobilised for BRI projects. To be fair, this is only a tiny fraction of the US\$1.5 trillion per year needed by Asia. But equally importantly, the projects reveal that China intends to exercise political leadership in the infrastructure space. By making infrastructure the centrepiece of its foreign economic policy, China is signalling its intention to work with partners – bilaterally through the BRI, and multilaterally through the AIIB – to help close infrastructure gaps. The political impact of China’s infrastructure leadership efforts will likely prove more significant than the economic contributions they offer.

Australia should actively engage with China’s infrastructure initiatives. One rationale is diplomatic, and the fact that these projects will prove very significant for regional politics in Asia. The BRI has been presented as the signature foreign policy initiative of the Xi administration;<sup>27</sup> and given the ‘comprehensive strategic partnership’<sup>28</sup> between the two countries, Australia cannot ignore the initiative. Australia is also a founding member of the AIIB, which has attracted widespread support from almost all countries in the Asia-Pacific,<sup>29</sup> as well as key extra-regional players such as the UK, Germany, Russia and India. The success of these infrastructure initiatives should be contrasted with recent developments in the regional trade space: the original TPP agreement collapsed due to the withdrawal of the US under President

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Donald Trump; and Regional Comprehensive Economic Partnership (RCEP) negotiations have become bogged down in disagreements amongst the members.<sup>30</sup> Diplomatically, a country with middle power aspirations like Australia needs to be fully engaged with this emerging domain of regional cooperation.

A further, oft-ignored rationale is economic: the Australian economy itself stands to gain considerably. Issues in rural and regional

areas notwithstanding, the comparatively high quality of Australian infrastructure means the country is unlikely to be a major recipient of BRI or AIIB investments. However, China-backed infrastructure projects in third countries offer several economic benefits for Australia:

- Relevant capacity – in design, construction, management and financing – means Australian service and technology firms are well placed to participate in the development of infrastructure projects.
- Improved infrastructure links will offer Australian exporters better access to markets in Asia. These opportunities are particularly prominent in the agro-food sector (where ‘continuous cold chain’ handling is required for perishable goods) and the energy sector (where pipeline and Liquefied Natural Gas (LNG) infrastructure is required to connect producers to key markets).
- Deeper economic integration within Asia will support further economic growth in regional economies, with concomitant trade and investment opportunities for Australia. As some 73 percent of merchandise exports presently go to Asia,<sup>31</sup> this will open new markets for the Australian economy.

Yet there are also a range of risks for Australian participation, which policymakers and businesses must carefully evaluate. A first concerns project governance. Large infrastructure projects are very risky. Long time horizons bring uncertainty, while social and environmental externalities impose costs that need to be managed. Historically, they have also been prone to waste, and in some countries corruption and rent-seeking. Existing international institutions, such as the World Bank and ADB, over decades of experience have developed mechanisms to manage these risks. These include a body of professional staff with technical experience, and an extensive set of international best practice policies to assess and mitigate project risks. But as new initiatives operating outside existing institutional frameworks, neither the BRI nor AIIB have such time-tested mechanisms in place. This is an especially acute problem for the BRI, where less experienced Chinese banks and SOEs will often be the lead implementing agents.

A second risk relates to perceived institutional competition between China's new initiatives and existing MDBs. Many commentators have raised concerns that its infrastructure moves are not a supportive adjunct to existing institutions, but rather an attempt to compete with and/or displace them.<sup>32</sup> These critiques emanate from arguments that China is adopting a 'revisionist' approach to global economic governance: rather than participation in long-standing (and typically Western-led) multilateral bodies, under Xi Jinping China has started developing new institutions that reflect its own priorities and preferences.<sup>33</sup> These may have the effect of diluting Western (particularly US and EU) influence in the global economy, and foster greater economic dependence on China amongst Asian countries.

These fears are reflected in the response of some governments to China's infrastructure initiatives. Both the US and Japan have declined AIIB membership invitations, citing concerns over competition with the World Bank and ADB.<sup>34</sup> Many EU states, who in 2015 joined the AIIB, have nonetheless expressed reservations about BRI participation on similar grounds.<sup>35</sup> The Indian government has gone furthest in publicly opposing the BRI, declaring in May 2017:<sup>36</sup>

We are of the firm belief that connectivity initiatives must be based on universally recognised international norms, good governance, rule of law, openness, transparency and equality...Connectivity projects must be pursued in a manner that respects sovereignty and territorial integrity.

A third, and arguably the most politically prominent risk concerns geopolitics. Sino-US (and to a lesser degree Sino-Japanese and Sino-Indian) great power rivalry has become a fact of life in Asia today. Unavoidably, China's infrastructure initiatives have come to be viewed through this prism. Just as the TPP was understood as the 'economic wing' of the Obama Administration's 'pivot to Asia' strategy,<sup>37</sup> so too is the BRI seen as the economic manifestation of a Xi administration program to establish geostrategic supremacy in Asia.<sup>38</sup> Comparisons to the Marshall Plan have proliferated amongst Western commentators,<sup>39</sup> though are routinely rejected in the state-run Chinese media.<sup>40</sup> Irrespective of the veracity of these competing discourses, they have created an environment in which China's infrastructure initiatives are linked to geopolitical considerations in the minds of policymakers. Many countries in the region – including, but not only Australia – must unavoidably ask challenging questions about whether participation in some way signals 'taking sides' between China, the US and other major powers.

**“Non-engagement is not an option, as it will diplomatically isolate Australia and deprive it of many economic benefits. Blind engagement is not an option either, given the range of governance, institutional and geopolitical factors that cast a shadow over the Chinese initiatives.”**

In Australia, this dilemma has translated into incoherent policy responses to China’s infrastructure initiatives. Viewed as an economic opportunity but a strategic risk, policymakers have struggled to adopt a consistent position on if, and on what terms, Australia will engage:

- **Vacillation on AIIB membership:** Australia initially considered joining the new bank during early stages of negotiation, but a proposal was then scuttled by the National Security Committee of Cabinet in November 2014 on ‘strategic grounds’.<sup>41</sup> It was widely

reported that the US had actively lobbied several regional governments, including Australia, to stay out.<sup>42</sup> Just months later, the Abbott government then performed a *volte face* to join the AIIB in March 2015, despite ongoing divisions within the cabinet.<sup>43</sup>

- **Mixed messages on the BRI:** Australia has tentatively engaged with some aspects but not others. In 2016, the ‘Australia-China One Belt One Road Initiative’ (ACOBORI) – an NGO designed to foster engagement between Chinese and Australian business leaders on the BRI – was established.<sup>44</sup> Trade Minister Steven Ciobo also attended the inaugural Belt and Road Forum in May 2017, indicating Australia saw ‘much merit’ in the initiative.<sup>45</sup> However, Australia also rejected an offer to ‘link’ the BRI with the Northern Australian Infrastructure Fund,<sup>46</sup> and is yet to sign a BRI MoU with China. There are public reports of an intragovernmental split on the BRI, with the trade and economic groups supportive but the security community opposed.<sup>47</sup>

As the Australia-China Relations Institute at the University of Technology Sydney has recently argued, it is now ‘decision time’ for Australia.<sup>48</sup> China’s twin infrastructure initiatives are set to transform the economies of Asia, and Australian policymakers and businesses need to develop a coherent position on how they will participate. Non-engagement is not an option, as it will diplomatically isolate Australia and deprive it of many economic benefits. Blind engagement is not an option either, given the range of governance, institutional and geopolitical factors that cast a shadow over the Chinese initiatives. Incoherent engagement is arguably worse: it sends mixed signals to China over Australia’s commitment to the bilateral relationship, and risks being excluded in favour of other partners with more effective engagement strategies. What Australia now needs is a coherent position that can be clearly communicated domestically and internationally, regarding how and on what terms it intends to participate in Chinese-led regional infrastructure initiatives.

**“What Australia now needs is a coherent position that can be clearly communicated domestically and internationally, regarding how and on what terms it intends to participate in Chinese-led regional infrastructure initiatives.”**

### **The AIIB as a ‘governance guarantee’ for regional infrastructure projects**

For Australian policymakers grappling with these issues, a critically important factor is the differences between the BRI and AIIB. Both efforts are China-led, and both aim to mobilise financial and political capital for regional infrastructure projects. But despite the common belief that they are intrinsically linked,<sup>49</sup> the reality is that they provide two distinctive governance models for regional connectivity. The AIIB offers a multilateral,

formally institutionalised and rule-governed model, which closely resembles the approach adopted by other MDBs.<sup>50</sup> The BRI offers a bilateral, informal and ad hoc model, led by Chinese agencies. These governance differences mean projects falling under one or the other initiative face different risk profiles.

Participation in BRI projects is inherently risky for Australian actors. Given the ad hoc and individually-negotiated character of the BRI program, it is difficult to generalise regarding how projects will be governed. There have been some (predominantly Western) criticisms of opaque governance, corruption and poor planning in several high-profile BRI projects, particularly those in Pakistan, Sri Lanka and Central Asia.<sup>51</sup> But there have also been some notable successes, such as a suite of electric power projects in Pakistan delivered on time and budget as part of the bilateral China-Pakistan Economic Corridor (CPEC) initiative.<sup>52</sup> A reasonable expectation is that some BRI projects will be well-planned and executed; others will suffer from major governance deficits; and many will fall somewhere between these poles. But the lack of a transparent, rules-based and consistently applied framework makes it very difficult to undertake ex-ante risk assessment for BRI projects.

AIIB projects, by contrast, are far less risky. This is because of the AIIB’s formal and transparent set of policies for project governance (see Box 1). The policies commit the AIIB to a set of international best practice principles when funding infrastructure projects, which include commerciality, competitiveness, transparency, anti-corruption measures, and social and environmental safeguards. Like other MDBs, any project seeking AIIB support must be assessed against these policies and principles and an assessment report provided to the 12-member Board of Directors before any financing decision is taken. These reports are made public (allowing independent evaluation); and projects are subject to ongoing monitoring and oversight by AIIB staff. In this way, external parties can have far greater confidence that AIIB projects will be well-governed, and have access to mechanisms for raising and managing concerns when they arise.

AIIB transparency is further augmented by its partnerships with other MDBs. It has negotiated MoUs with many of its peers, which facilitate information sharing and coordination on joint investment projects.<sup>53</sup> These MoUs commit the AIIB to upholding the policy requirements of its peers during joint projects. Since commencing operations in early 2016, the AIIB has largely favoured a 'joint venture' model, joining the pre-existing projects of other MDBs to speedily 'bootstrap' the new bank into operation. Of the 23 projects it has financed, in only six, accounting for one-third its total loan book, has the AIIB been the 'lead lender' responsible for project governance (see Appendix). This joint venture model compares starkly to the BRI, where

### **BOX 1. Principal AIIB policies and governance mechanisms, March 2018**

**Operational Policy on Financing** lays out commercial criteria for how potential projects would be assessed, and how financing packages would be structured.

**General Conditions for Sovereign-backed Loans** outlines a standard set of terms for loan financing, terms, project execution, and mechanisms for variations to loan packages.

**Sovereign-backed Loan and Guarantee Pricing Policy** sets transparent interest rates (LIBOR plus specified adjustments) for loans to host government-backed projects.

**Procurement Policy** outlines a commercially-oriented set of procurement goals, which emphasise efficiency, value-for-money, fitness-for-purpose and transparency.

Accountability and transparency are achieved through a **Public Information (Interim) Policy and Directive and Policy on Prohibited Practices**; while **Codes of Conduct** for directors and management personnel enforces ethical standards and anti-corruption measures.

**Environmental and Social Framework** provides a mechanism to evaluate the broader societal impacts of projects during the assessment process.

**Risk Management Framework** provides a mechanism for evaluating, minimising and managing a variety of defined financial, operational, integrity, environmental, social and reputational risks.

**Operational Policy on International Relations** sets conditions under which loans can be made to projects involving international waterways, disputed areas, 'de facto governments' and UN Security Council measures.

Source: Author's summary, from Asian Infrastructure Investment Bank, 'Policies and Strategies' [www.aiib.org/en/policies-strategies/](http://www.aiib.org/en/policies-strategies/).

Chinese agencies typically act on their own as principal implementing agents. When participating in an AIIB project, external parties have confidence they are working with a team of legitimate and reliable partners.

The AIIB is arguably subject to far less geopolitical baggage. BRI projects are very diverse and while some have proven relatively uncontroversial others have been a source of major discord. Key examples of the latter are Gwadar Port<sup>54</sup> in Pakistan and Hambantota Port<sup>55</sup> in Sri Lanka, both of which have been internationally criticised as a Chinese attempt to gain military footholds on the northern littoral of the Indian Ocean. The multilateral (rather than Chinese-controlled) AIIB is less likely to attract controversy. There is widespread political buy-in, with 63 governments currently AIIB members, including all G20 members except the US and Japan. China has no veto power over funding decisions, which are made in a transparent matter by the member-controlled Board of Directors. Were an internationally contested project to be pitched, it would be unlikely to proceed through the rules-governed AIIB processes. While AIIB mechanisms do not eliminate geopolitical risks, they are greatly minimised relative to the BRI.

In these ways, the AIIB functions as a ‘governance guarantee’ for China-backed infrastructure projects. Governments and businesses participating in AIIB projects can be confident these will be governed as per international best practices; will involve reliable and trustworthy partners; and are less likely to be a source of geopolitical tension. Of course, risk can never be eliminated, and no MDB can claim a perfect record in its financing activities. Nonetheless, the three key risks for Australian participation in Chinese infrastructure initiatives – concerning project governance, institutional competition and geopolitical controversy – are all greatly reduced. By offering a multilaterally-endorsed and rules-based framework, the involvement of the AIIB provides assurances that an infrastructure project will face fewer risks than a bilateral BRI alternative.

## Steps for maximising Australia’s engagement with Chinese infrastructure initiatives

**Australia needs a clear, coherent and communicable policy on participation in China-led regional infrastructure initiatives.** Chinese efforts in the infrastructure space promise to profoundly transform the physical infrastructure linking Asian economies. Given the economic opportunities for Australia, and the importance of constructive relations with Asia’s largest economy, Australia cannot sit these initiatives out. However, Australian actors cannot simply follow existing templates given the governance and political risks some of the projects may pose. The current situation of policy incoherence is arguably worse, as it sends mixed messages to businesses, regional partners, and the Chinese government over Australian participation.

**AIB members in the Asia-Pacific**





The Australian government therefore needs to develop a coherent policy position on its engagement with these China-led infrastructure projects. This should outline the principles that inform Australia's perspective on infrastructure development, the governance provisions required for Australian participation, and be transparently communicable to partners. Developing such a policy will ensure China and other regional partners can form clear expectations of Australia's preferences, role and potential scope for contribution.

**The AIIB provides an institutional mechanism for facilitating Australian participation.** The governance provisions which Australia and like-minded partners negotiated into the AIIB provides guarantees that infrastructure projects will be transparently-managed, commercially-oriented and deliver economic, social and environmental returns. As the AIIB is a multilateral institution with a broad membership, its projects are also less politicised than the bilateral and mini-lateral BRI initiatives led by Chinese banks and SOEs. The risk factors that constrain Australian participation in BRI projects are reduced significantly by the governance guarantees that AIIB involvement in a project offers.

**Australia should develop and communicate an 'infrastructure engagement strategy' based around the AIIB.** Australia was one of the first Western countries to join the bank; and is currently a founding member, its sixth largest shareholder, and holds one of the 12 directorships.<sup>56</sup> Given its demonstrated commitment to the AIIB, Australia can reasonably request that its involvement in China-led infrastructure projects is undertaken through this institution. Importantly, this strategy must also be communicated to key stakeholders, including both businesses and government, to prevent the misunderstandings and mixed messaging that have previously cast a shadow over Australia's position.

**Australia should actively contribute to the development of the AIIB's institutional capabilities by taking a leading role in project preparation work.** As a board member and major shareholder, Australia already plays a significant role in AIIB governance. However, it could carve out a more active role in assisting efforts to develop the AIIB's technical capacity and project pipeline:

- The key issue for infrastructure development in Asia is not a shortage of capital, but rather the 'bankable projects problem' of identifying, designing and preparing projects.
- As a high-skill economy with extensive expertise in infrastructure development and financing, project preparation is an area in which Australia could make a substantial contribution.

**“The risk factors that constrain Australian participation in BRI projects are reduced significantly by the governance guarantees that AIIB involvement in a project offers.”**

- The Australian government should work with AIIB staff and officials from recipient countries to identify opportunities, develop project plans and provide technical and commercial expertise. These efforts should initially focus on countries with which Australia has strong existing bilateral economic ties, particularly Indonesia, Malaysia and Timor Leste.

- The AIIB currently has a Project Preparation Special Fund (PPSF), specifically dedicated for project preparation activities. However, it is presently under-resourced relative to the bank’s subscribed capital base, and only three members have made contributions to date.<sup>57</sup>

- Australia should consider becoming the fourth contributor to the PPSF. This would both signal its intent to provide leadership within the AIIB in technical domains, as well as reaffirm the importance of transparent project preparation work in securing good governance for infrastructure projects.

**Australia can also use the AIIB to improve its economic relationships with key partners in Asia.** Given the enormity of the challenge facing the region, many Asian governments have made infrastructure a national policy priority. Indonesia has recently launched a package to develop US\$327 billion of infrastructure projects;<sup>58</sup> Vietnam’s infrastructure spend now averages 5.7 percent of GDP;<sup>59</sup> while India has committed to building US\$108 billion of new roads over the next five years.<sup>60</sup> ASEAN has also upgraded the status of infrastructure cooperation on its agenda and in 2016 issued its first Master Plan on ASEAN Connectivity.<sup>61</sup> By working through the AIIB, and specialising in much-needed but under-supplied project preparation activities, Australia can actively contribute to these partners’ national development initiatives. This could function as a foundation for the strengthening of broader bilateral economic ties, particularly with India and Indonesia where Australia currently has ongoing free trade agreement negotiations.

**Finally, Australia can leverage its role within the AIIB to shape the direction of the broader BRI program.** As noted earlier, the BRI is not a specific and detailed program, but rather a guiding framework. Designed to mobilise Chinese agencies to accelerate their infrastructure activities abroad, there is considerable flexibility over where, by whom, and under what governance provisions projects will be managed. The BRI is itself an open template, which must be customised to meet the needs and preferences of the partners involved in a particular project. Importantly, this means that BRI governance will be shaped by the involvement of project partners.

To shape the BRI, one must first be actively engaged with it. Uncertainty over project governance and anxieties over potential geopolitical externalities are real and legitimate concerns. Yet non-engagement would mean Australia is refusing an opportunity to shape BRI projects in a way that reflects the governance principles for which it advocates. Using the AIIB as a governance guarantee will not only allow Australia to participate in China-led infrastructure projects, but also transform these projects in a direction more compatible with its principles, preferences and priorities. Irrespective of Australia's policy decisions, China's twin infrastructure initiatives will transform the connectivity between Asian economies. Australia should use the AIIB as an institutional mechanism to positively shape this outcome.

## Appendix

TABLE 3  
AIIB-funded projects, March 2018

Source: Project databases of AIIB and other IFIs. All values in USD millions.

\*The India Infrastructure Fund received an equity investment; all other AIIB contributions were made as commercially-priced loans.

Funding Date	Country	Name	Lead lender/s	AIIB involved at launch?	AIIB	Other MDBs	Other partners	Total project value
Jun 2016	Bangladesh	Power distribution system upgrade	AIIB	Yes	165	97		262
	Indonesia	Slum upgrading project	WB	No	216.5	216.5	1310	1743
	Pakistan	Shorkot-Khanewal M-4 Motorway upgrade	ADB	No	100	134	39	273
	Tajikistan	Dushanbe-Uzbekistan road improvement	EBRD	No	27.5	62.5	16	106
Sep 2016	Pakistan	Tarbela-5 Hydropower extension	WB	No	300	390	133	823
	Myanmar	Myingyan CCGT power plant	ADB, IFC	No	20	117		137
Dec 2016	Oman	Railway system preparation planning	AIIB	Yes	36		24	60
	Oman	Duqm Port commercial terminal	AIIB	Yes	265		88	353
	Azerbaijan	TANAP Pipeline	WB	No	600	2600	5400	8600
Mar 2017	Indonesia	Dam operational improvement and safety	WB	No	125	125	50	300
	Indonesia	Regional Infrastructure Development Fund	WB	No	100	103	203	406
	Bangladesh	Natural Gas infrastructure upgrade	ADB	No	60	167	226	453
May 2017	India	Andhra Pradesh power distribution upgrade	WB	No	160	240	171	571
Jun 2017	Georgia	Batumi Bypass road project	ADB	No	114	114	87	315
	India	India Infrastructure Fund*	None	No	150		600	750
	Tajikistan	Nurek Hydropower Rehabilitation Phase I	WB (IDA)	No	60	225	65	350
	India	Gujarat rural roads upgrade	AIIB	Yes	329		329	658
Sep 2017	Egypt	Egypt Round II Solar PV Feed-in Tariffs Program	IFC	No	19	41	15	75
	Multi-country	IFC Emerging Asia Fund	IFC	Yes	150	150	340	640
	Philippines	Metro Manila Flood Management Project	WB	No	207	207	85	500
Dec 2017	India	Bangalore Metro Rail Project – Line R6	EIB	Yes	335	583	867	1785
	Oman	Broadband Infrastructure Project	AIIB	Yes	239		228	467
	China	Beijing Air Quality Improvement and Coal Replacement Project	AIIB	Yes	250		511	761
<b>Total</b>					<b>4028</b>	<b>5572</b>	<b>10787</b>	<b>20388</b>



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## About UTS ACRI

For the first time in its history, Australia's most important economic relationship is with a nation very different in governance, politics and values. In the past, Australia's dominating economic relationships have been with the British Empire, the United States and Japan.

Today our most important economic partner is China.

China contributes now more to world economic growth than any other country. China absorbs 34 percent of Australian goods exports. By 2030, 70 percent of the Chinese population is likely to enjoy middle class status: that's 850 million more middle class Chinese than today.

In 2014 the University of Technology Sydney established the Australia-China Relations Institute (ACRI) as a think tank to illuminate the Australia-China relationship.

Chinese studies centres exist in other universities. ACRI, however, is the first think tank devoted to the study of the relationship of these two countries.

The Prime Minister who opened diplomatic relations with China, Gough Whitlam, wrote in 1973: 'We seek a relationship with China based on friendship, cooperation and mutual trust, comparable with that which we have, or seek, with other major powers.' This spirit was captured by the 2014 commitments by both countries to a Comprehensive Strategic Partnership and the 2015 signing of a Free Trade Agreement.

## About the author



Dr Jeffrey Wilson is an academic, policy analyst and consultant with expertise in the international economic relations of the Asia-Pacific. He has consulted for government and businesses in Australia on trade policy issues, and has contributed to a range of national and international policy dialogues involving the US, China, Korea, Indonesia, India and Australia. He is the author of two books, over two dozen scholarly articles and chapters, and a wide range of policy analyses and reports for both Australian and international audiences.

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