BELTS, ROADS, AND REGIONS: THE DYNAMICS OF CHINESE AND JAPANESE INFRASTRUCTURE CONNECTIVITY INITIATIVES AND EUROPE’S RESPONSES

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Abstract

The paper argues that East Asia is setting the pace for the recent trend in regional and inter-regional integration, which is associated with multilateral infrastructure connectivity initiatives, like the “Belt and Road Initiative” (BRI) of the People’s Republic of China and Japan’s “Partnership for Quality Infrastructure” (PQI). After introducing key issues, the paper explains the logic behind the recently grown importance of such initiatives and analyzes concepts like the BRI and PQI against this background in more detail. While infrastructure connectivity initiatives promise to combine national political, economic, and multilateral public good aspirations beneficially, conflicts among them are also possible and even likely. The paper then deals with Europe’s, and particularly the EU’s, role in this dynamism. The EU was one of the early movers, with the establishment of the European Investment Bank for instance, but its mechanisms have so far not become pillars of a coherent and forceful political–economic strategy of the EU. The current European situation is rather one of reacting to a dynamic that other countries elsewhere have created. The paper introduces the 2018 Joint Communication “Connecting Europe and Asia: Building Blocks for an EU Strategy” in this context and finds it to be lacking in various ways. The paper ends with conclusions and policy recommendations on some of the options for developing a more forceful European strategy.

Keywords: infrastructure investment, connectivity, East Asia, Europe, European Union, Belt and Road Initiative, People’s Republic of China, Japan

JEL Classification: F21, F55, H54, H87, L91, O19, O57, P45
1. INTRODUCTION

Infrastructure matters; connectivity matters. The field is quickly developing into one of the major international and multilateral policy fields, next to international trade and foreign direct investment. Infrastructure encompasses around 14% of the global GDP, and it is likely to gain in importance over many years to come (McKinsey Global Institute 2017). The Organisation for Economic Co-operation and Development (OECD) noted, focusing on transport: “Transport infrastructure is crucial to connect developing countries and help them to boost trade, growth and regional integration” (OECD 2018, Caption). Beyond economics, as the People’s Republic of China (PRC) tries to invigorate its posture in the regional and multilateral order and reshape some of its features, it has chosen connectivity, through its Belt and Road Initiative (BRI) and new mechanisms like the Asia Infrastructure and Investment Bank (AIIB), as a major route to pursue this ambition.

This paper analyzes the dynamics of infrastructure connectivity, which initiatives from East Asia, namely the PRC and Japan, considerably shape. The second aim of the paper is to study and evaluate how Europe and the EU in particular react to these developments. The public choice view of international political economy (Frey 1984) informs our approach. The idea is to apply the basic premises of neo-classically inspired economics to issues of international relations. For instance, we can understand the introduction of an infrastructure initiative as creating a public good, as the paper will show below.

The organization of the paper is as follows. The second section explains the logic behind the recently grown importance of infrastructure initiatives. The third section analyzes concepts like the PRC’s BRI and Japan’s Partnership for Quality Infrastructure (PQI) against this background in more detail. Section four deals with Europe’s, particularly the EU’s, role in this dynamism. The final section, containing conclusions and policy recommendations, discusses some of the options for developing a more forceful European strategy.

2. THE GROWING IMPORTANCE OF INFRASTRUCTURE CONNECTIVITY

Infrastructure and connectivity have received a considerable amount of attention in recent years, both for economic and for political reasons. The literature has treated infrastructure and connectivity as closely related concepts, the former rather focusing on the input side and the latter on the output side. Connectivity (as well as infrastructure) involves different types of networks, ranging from the physical domain, like transport—roads, railways, sea, and air—or energy, to digital and other information flows, financial and people-to-people networks (GICA 2018). First, connectivity, particularly transport infrastructure, is a crucial factor for international trade and economic growth but also for other concerns, like regional integration and the Sustainable Development Goals (OECD 2018, 15). On the level of cross-country comparison, a positive correlation between infrastructure and GDP growth is undeniable, although the direction of causation is more difficult to establish (ADB 2017, 37). On the basis of country case studies, infrastructure development played a significant role in the fast economic development of East Asia, including the PRC, Japan, and the Republic of Korea.

Important beneficiaries share the basically positive view of the role of extended infrastructure, and the ASEAN group of Southeast Asian economies is a case in point.
Vision 2020 and the ASEAN Economic Community of 2015 already contained important ideas to develop a competitive economic region, including infrastructure. The Master Plan on ASEAN Connectivity 2025 focuses on five key areas, namely sustainable infrastructure, digital innovation, seamless logistics, regulatory excellence, and people mobility. It formulates the following as a vision: “To achieve a seamlessly and comprehensively connected and integrated ASEAN that will promote competitiveness, inclusiveness, and a greater sense of Community” (ASEAN 2016).

Second, the spread of global supply chains has made connectivity even more important and attractive for the benefit of more efficient networks of production. To make full use of declining transport and communication costs, it is necessary to create appropriate transport networks and other linkages on the basis of substantial infrastructure investment.

An important Asian Development Bank (ADB)/ADB Institute (ADBI) study of 2009 estimated the infrastructure needs of the Asian region to be around $8 trillion by 2020. The policy conclusions of the 2009 ADB/ADBI study almost sound like a blueprint for the PRC’s One Belt One Road agenda of 2013: “This study’s long-term vision is the creation of a seamless Asia: an integrated region connected by world-class environment-friendly infrastructure networks that link national markets with distinct strengths, promote strong and sustainable economic growth, provide for people’s basic needs, and thus help reduce poverty” (ADB and ADBI 2009, 26).

A 2017 update of the ADB study confirmed the trend of the vast needs in the region (ADB 2017). The new estimate for the infrastructure investment that the region requires is $22.5 trillion until 2030. According to McKinsey Global Institute (2017), there is a global need for some $3.7 trillion per year up to 2035 with a gap of a total of $5.5 trillion. The needs are particularly strong in Asia, while the gaps vary widely between countries. For instance, there is an expectation that the PRC will record a domestic surplus over the years.

Third, the financing gaps have become particularly noticeable since the Global Financial Crisis of 2008–09. Private investment finance declined significantly after the crisis (Bhattacharya and Romani 2013): in terms of long-term syndicated bank lending, infrastructure lending reached a peak of more than $50 billion in 2007 and fell to $30 billion and below in the years to 2012. If the role of national government budgets and national development banks of the Global South is limited, multilateral development banks (MDBs), like the World Bank, or regional development banks (RDBs) could offer relief. However, during those years, MDBs and official development assistance only contributed a minor part of less than 10% to the annual global spending on infrastructure, amounting to around $0.8 trillion to $0.9 trillion. Moreover, while the MDB lending for infrastructure peaked at around $70 billion for the years 2009 and 2010, it decreased in the following years (Bhattacharya and Romani 2013).

Fourth, another concern in the years following the Global Financial Crisis was (and still is) the engines for global economic growth. For many years, there has been strong growth of trade originating from economic globalization. In recent years, however, global trade has been stagnating at best. Already in 2010, the Harvard Business Review published an essay on a possible “Peak Globalization” (Nussbaum 2010). The reasons for such concerns are manifold. Among them, it has been difficult to create and sustain further trade liberalization and facilitation, as is clear from the stalling WTO negotiations and the rising protectionism in many countries, including the US under the Trump administration. In comparison, infrastructure expenditures are still likely to grow significantly. Infrastructure makes up about 14% of the global economy (McKinsey Global Institute 2017). From that perspective, it is possible to interpret a multilateral effort
to invest in infrastructure as a highly welcome growth initiative. Indeed, the Seoul summit of the G20 in 2010 discussed utilizing global savings surpluses to meet pressing infrastructure needs in this spirit (Kohli 2015). Finding appropriate financing mechanisms is essential for using the resources effectively (Yoshino et al. 2018).

If the arguments listed above are compelling, it is necessary to ask why it has been so difficult in the past to finance and set up appropriate connectivity investments. The basic reason is the public good properties of infrastructure investment. According to basic economics, there are few incentives for potential beneficiaries of public goods to finance such products, if non-excludability and non-rivalry hold. While infrastructure is not a perfect public good, its public good properties are powerful enough to create the mentioned problem: there is strong de facto non-excludability due to exorbitant costs of exclusion for several goods like roads. Moreover, there is non-rivalry at least for the transaction cost benefits of establishing infrastructure ecosystems. There are also significant positive externalities, which can hardly exclude non-contributors. The meritocratic properties of access and opportunities are also frequent claims. Moreover, it is notable that transnational infrastructure creates additional public good issues of global vs. regional or bilateral provision (Sandler 2013).

What is necessary for a country to take the lead in providing an infrastructure initiative as a public good? In the case of multilateral public goods, the standard answer is that a “benevolent hegemon” (originally Kindleberger 1973) is necessary. Compared with the usual economic benefits and costs, which are not enough for a country to provide a public good, the potential advantages for the hegemon also include political benefits, like prestige, agenda-setting power, and influence. Such political benefits can become particularly relevant in a leadership contest.

An important consideration in this context is the changing political and economic weights in the region. While the importance of the PRC has significantly increased in recent years and it is actively seeking a more prominent role, Japan’s position has relatively weakened, while the US has set other priorities. Whereas the “Pivot to Asia” strategy of the Obama administration did have a trade and investment component, the focus of the initiative was rather strategic and military.

For the PRC, this situation provided compelling reasons to start a major infrastructure initiative. Compared with the usual cost–benefit analysis of incumbent or aspiring leaders, the PRC, in the years after the Global Financial Crisis, could realize a number of peculiar advantages: the economic cost of starting such an initiative and providing significant funds as an early mover faced lower fiscal and economic burdens than usual due to the existence of ample foreign exchange reserves. The economic benefits also promised to be especially high: because of relatively low wages and ample construction industry capacity, even over-capacity, the PRC could expect to win a significant number of international contracts. If one includes distributional concerns in the economic benefits, support for the backward western regions of the PRC through improved connectivity with Eurasia via Central Asia was a valuable additional plus factor. Finally and most importantly, such an initiative promised significant political benefits for an aspiring international leader in terms of influence, agenda setting, and increased reputation. The delay of the 2010 reform of the IMF and the World Bank to change the voting shares in favor of poorer and upcoming countries contributed to the PRC’s search for ways to establish itself as an international leader by providing an alternative approach to installing public goods. An infrastructure investment initiative could therefore appear as an ideal instrument in the light of the circumstances of the years around 2010.

The following section will trace the PRC’s approach and Japan’s reaction in some detail, arguing that the initiatives that have emerged in East Asia during recent years have very
much shaped the recent dynamics, to which the EU also relates, as the study will show further below.

3. THE PRC’S INFRASTRUCTURE INITIATIVE AND JAPAN’S “PARTNERSHIP FOR QUALITY INFRASTRUCTURE”

3.1 PRC Infrastructure Initiatives: Belt and Road and Beyond

The Archimedean point from which to interpret recent infrastructure initiatives is the PRC’s Belt and Road Initiative (BRI), which President Xi Jinping announced in 2013; it was originally referred to as One Belt One Road (OBOR). It is hard to overstate its importance as a game changer in multilateral cooperation: searching Google Scholar in May 2019, one could already find some 14,000 entries for OBOR plus the PRC and even 68,000 for BRI plus the PRC. Here, it may suffice to list some fundamentals and rather focus on the dynamics since 2013 (for the early years, see for example Li and Schmerer, 2017; for a recent overview, see Fang and Nolan 2019). The proposal, which the President Xi Jinping announced in two speeches during 2013, focused on connectivity across Eurasia, a “belt” with three routes and a maritime “road” with two southern routes. Initially, the proposal identified 58 countries as potential partners. Cooperation would be based on bilateral memoranda of understanding between the PRC and individual countries. It defined specific roles for Chinese regions, particularly inland regions. While it emphasized the connectivity aspect, the proposal encompassed five links: policies, infrastructure, trade, finance, and people. Various financial mechanisms would become involved, quite a few of which were newly created: the Silk Road Fund, established in late 2014 with $40 billion from forex resources, the PRC’s sovereign wealth funds, including the China Investment Corporation (CIC), major national policy banks, like the China Development Bank and the China Ex-Im Bank, the newly created Asian Infrastructure and Investment Bank (AIIB), and the New Development Bank BRICS (NDB), plus other mechanisms, for instance the Shanghai Cooperation Organization Interbank Consortium, the China–Central and Eastern Europe Investment Cooperation Fund, and the China–Eurasian Economic Cooperation Fund (see, for instance, Delman 2019).

Among these mechanisms, the AIIB is the most widely discussed one, as it seems to challenge the established MDBs, like the World Bank or the regional Asian Development Bank, and thus it is possible to interpret it as a vanguard for how the PRC would try to influence the framework of global and regional multilateral relations. Xi Jinping announced the new MDB in 2013, and it started business in December 2015 with 57 founding members, including Australia, the Republic of Korea, the UK, and Germany but not the skeptical US and Japan. The bank was endowed with capital stock of $100 billion, of which $20 billion was paid-in capital. In terms of governance, the regional members account for not less than 75% of the votes, of which the PRC holds 26%; major institutional decisions require a super majority of 75%, so the PRC has a very strong position. The AIIB, which is located in Beijing, has non-resident Boards of Governors and Directors, and the first President is from the PRC; among the five Vice Presidents, there is a British and a German national.

From the beginning, critical voices have questioned the prudence of the new MDB. For instance, they have pointed out that non-resident directors could weaken the role of voice
in monitoring senior management. The organization has intentionally installed a number of self-binding mechanisms, however: extensive stipulations of environmental and social standards, a strong role of co-financing with established mechanisms like the ADB and the European Bank for Reconstruction and Development, and vice presidents plus a chief risk officer from Western countries. So far, the AIIB has acted more prudently than the critics expected. It seems that projects that meet the stringent standards are not easy to identify, so the bank has usually been the junior partner in co-financed projects so far. This also explains why progress in terms of AIIB lending is slower than people expected: while the goal is disbursements of $10 billion–$15 billion per year, between 2016 and September 2018, the amount was only around $6.4 billion. As a percentage of outstanding BRI-related loans, Deloitte (2018) estimated that the AIIB so far accounts for no more than 1%.

If one tries to characterize the whole project of the BRI from the perspective of six years after its foundation, we suggest that four features are prominent. First, the BRI is deeply embedded in the political and economic strategic positioning of the PRC. In addition to using a temporal “window of opportunity” cannily to create leadership in infrastructure investment with the associated political and economic benefits, as discussed above, the BRI provides an answer to the long-standing domestic debate on how to support the laggard economic regions in the Western PRC. Moreover, it fits the regional shift of foreign policy from “responsive diplomacy,” which includes “keeping a low profile” under Deng Xiaoping and his successors, to a “proactive policy” under Xi Jinping, the latter also including an aspiration for “discourse power” (Kohlenberg and Godehardt 2018; Delman 2019).

Second, the concept is an evolving one, and adaptation involves learning. The Chinese authorities themselves see it as a “vision” or an “initiative” that can adapt. For example, the PRC made the key document of the BRI public only in 2015, two years after Xi Jinping’s announcement of the BRI (National Development and Reform Commission 2015). As another example, the lead of the PRC has modified the use of bilateral agreements to allow for more equal multilateral arrangements.

Third, there is considerable opacity about the project (Öztürk 2019). There are no headquarters, and the National Development and Reform Commission, the Ministry of Finance, and the Ministry of Commerce share the responsibilities and to some extent compete for influence. There is no unified budget or detailed regular reports. Decisions about membership are not rule based, and the willingness to sign an MOU seems to be more important than the priority of creating connectivity. There is also no autonomous multilateral conflict resolution mechanism, only a PRC-led arbitration court, to mention but a few examples.

Fourth, the PRC’s leadership claims win-win situations. President Xi Jinping reiterated this in his keynote to the Second Belt and Road Forum in 2019: “We need to promote a global partnership of connectivity to achieve common development and prosperity. I am confident that as we work closely together, we will transcend geographical distance and embark on a path of win-win cooperation” (Xi 2019). While this is a sharable hope, it is by no means clear, given the opacity that we discussed earlier, that it is possible to meet this claim fully. It is rather symbol politics to gain support at home and abroad.

3.2 Japan’s “Partnership for Quality Infrastructure” in the Context of Other Initiatives of Japan and the PRC

The second major player in East Asia is Japan. Researchers have frequently argued that Japan became active only as a reaction to the PRC’s BRI strategy. However, Japan has
been active in infrastructure initiatives for a long time. Japan has always emphasized infrastructure-related projects in its official development assistance policy, based on its own development experience but also on its business interests (Rix 1980), even during times when the global OECD Development Assistance Committee community did not particularly support this (Kato 2016). Still, the PRC’s approach clearly influences the style of its more recent post-2013 initiatives. The study will therefore compare specific features of Japan’s policies with those of the PRC, which will clarify Japan’s position much better than by simply outlining it without such cross-references.

Southeast Asia has traditionally been the focus of Japan’s aid, but the country has also developed initiatives elsewhere. The Hashimoto Government (1996–1998) set up a so-called “Eurasian diplomacy” in the context of the democratization and transformation of East European/Central Asian economies. It focused on political goals like dialogue and the support of democracy just as much as on economic cooperation and cooperation for natural resource development. A somewhat more specific “Central Asia Plus Japan” followed in 2004 as part of the government that Prime Minister Koizumi led. It included a policy dialogue, intra-regional cooperation, business promotion, intellectual dialogue, and cultural as well as people-to-people exchanges. The government had other priorities, however, and Koizumi visited the region only late during his term as prime minister. It propagated the short-lived “Arc of Freedom and Prosperity” in 2007 as a “value-oriented diplomacy” (Yuasa 2008). Shinzo Abe introduced cooperation in the Indo-Pacific region among Australia, India, Japan, and the US as an option during his first turn as Prime Minister in 2006–07. In his ‘Confluence of Two Seas’ speech to the Indian Parliament in August 2007, he noted: ‘By Japan and India coming together in this way, this ‘broader Asia’ will evolve into an immense network spanning the entirety of the Pacific Ocean, incorporating the United States of America and Australia. Open and transparent, this network will allow people, goods, capital, and knowledge to flow freely. … In addition, as maritime states, both India and Japan have vital interests in the security of sea lanes” (Abe 2007). About a month later, Abe stepped down as Prime Minister, and it took about ten years for this line of reasoning to reappear in the context of the “Free and Open Indo-Pacific” (FOIP) idea, which the Trump-led US administration supported.

The latter observation already points to some of the major reasons why these early initiatives bore rather little fruit. One context is the domestic political instability in Japan, with several short-lived cabinets, which precluded a coherent and sustained policy approach. The second point is that objectives were somewhat blurred and poorly linked, oscillating between Western values and conventional economic development (Yoshimatsu 2017, 503). Third, domestic (economic) interests did not highlight the forceful mobilization of resources in those years; related to the observation noted above, the economic case for a “window of opportunity” to install a major infrastructure initiative had not yet arrived before around 2010.

Activities did continue, however. In 2010, the Research Institute for ASEAN and East Asia (ERIA), an institution that Japan and ASEAN founded in 2006, presented the Comprehensive Asia Development Plan (CADP) to the East Asia Summit. The CADP’s conception was “as a grand spatial design for infrastructure development in East Asia. The conceptual framework … demonstrates how the region can pursue deepening economic integration as well as narrowing development gaps” (ERIA 2012), including a list of potential projects.

Efforts also continued on the governmental level. The Abe administration, after winning the December 2012 general election, installed a Ministerial Meeting on Strategy Relating Infrastructure Export and Economic Cooperation in 2013. Abe gave it a clear mandate: “Supporting the overseas business of Japanese companies and pushing forward the
export of the most advanced infrastructure system are an important pillar for the growth strategy … Japan must aim for achieving growth and prosperity together with the world, through these kinds of cooperation” (Abe 2013). The Infrastructure Export Strategy became part of the third “arrow” of economic reforms of the Japan Revitalization Strategy, endowed with 30 trillion yen until 2020.

The principal Japanese initiative in recent years has been the Partnership for Quality Infrastructure (PQI) of 2015. With an amount of $110 billion, people usually understand it as a reaction to the PRC’s BRI, while the above shows that there is a legacy from earlier Japanese endeavors. The four pillars of the PQI are: (1) expansion and acceleration of assistance through the Japan International Cooperation Agency (JICA), Japan’s principle technical ODA-distributing agency; (2) collaboration with the ADB; (3) measures to increase the supply of funding through the Japan Bank for International Cooperation and others; and finally (4) promoting relevant international standards (MOFA et al. 2015). Some features of the PQI corroborate the impression that the intention is for the PQI to respond to the BRI one way or another: the claim of “quality” tries to differentiate Japan’s proposal from the arguably cheaper and less sophisticated offers from elsewhere. In addition, projects will be based on each country’s development plan, an alternative to the original bilateral and asymmetrical approach of the BRI, thus making it attractive for countries like India. Moreover, laying stress on cooperating with established mechanisms like ADB underlines the “quality” claim and is different from the PRC’s support of novel organs like the AIIB. In 2016, Japan extended the PQI from $110 billion to $200 billion, introducing a global reach for all parts of the program, not only standard setting, and widening it to projects beyond infrastructure, thus also involving other organizations in the field of energy, raw materials, and beyond.

In addition to the aspects mentioned, there are other features that are somewhat different from the BRI scheme. One such feature is the role of private business in Japan’s proposal, which is much stronger than in the BRI case, in which state-owned enterprises in the PRC play an important role (Deloitte 2018). On the Japanese side, in 2014, the country formed the Japan Overseas Infrastructure Investment Corporation for Transport & Urban Development (JOIN) with the motive of supporting and facilitating Japanese corporations’ participation in the global infrastructure market. While the Japanese state holds a majority in JOIN, the Japan Infrastructure Initiative (JII), which it established in 2017, basically runs through private enterprises such as the Hitachi Capital Corporation, Mitsubishi UFJ Lease & Finance Co., Ltd, and MUFG Bank, Ltd. The goal is to help close the funding gap for global energy, transport, ICT, or water infrastructure and thus support Japanese manufacturers, engineering companies, and others.

One important difference between the PQI and the BRI is the expected size of the whole initiative (it should be noted that, strictly speaking, there is no logical connection between the two initiatives; however, both are the lighthouse infrastructure project of their respective government, and, through comparison, one can thus carve out their peculiar features, as we argued previously). Popular estimates for the BRI range from $1 trillion to $8 trillion (Hillman 2018), while the PQI’s announced level is $200 billion. From that perspective, the BRI seems to be significantly more substantial and deserves greater public awareness. However, a ratio of 5:1 or even 40:1 may exaggerate the actual differences. The derivation of the different numbers is not entirely clear. This is to some extent a result of the opaqueness of the BRI, but also, in the Japanese case, it is not entirely clear whether “regular” already foreseen spending on ODA or other spending is part of the $200 billion mark. With the involvement of Japan’s resourceful private business sector, the “multiplier effect” of any fiscal expenses may be somewhat higher.
in Japan, however. Moreover, it is noticeable that people cannot always take the alleged bountifulness of the PRC’s forex resources for granted either. The PRC’s direct investment flows into BRI countries actually declined between 2015 and 2017, which may be due either to more stringent profitability and risk awareness or to a limitation of funds (Deloitte 2018). More recently, with the PRC’s current account surplus declining rapidly in 2019 due to US–PRC trade friction, forex resources seem harder for overseas projects to obtain.

Another noteworthy feature of Japanese activities is their engagement with multilateral mechanisms to set standards for “quality infrastructure.” The 2016 G7 Ise-Shima Summit, which Japan organized and chaired, had already passed the Principles for Promoting Quality Infrastructure Investment (Table 1).

Table 1: 2016 G7 Ise-Shima Principles for Promoting Quality Infrastructure Investment

| Principle 1 | Ensuring effective governance, reliable operation, and economic efficiency in view of life cycle costs as well as safety and resilience against natural disaster, terrorism, and cyber-attack risks |
| Principle 2 | Ensuring job creation, capacity building, and transfer of expertise and know-how for local communities |
| Principle 3 | Addressing social and environmental impacts |
| Principle 4 | Ensuring alignment with economic and development strategies, including aspects of climate change and environment, at the national and regional levels |
| Principle 5 | Enhancing effective resource mobilization including through PPP (i.e., public–private partnerships) |

Source: MOFA (2016).

In 2018, the Asia-Pacific Economic Cooperation (APEC) forum passed a revised guidebook, which the METI authored, in line with Japan’s views (APEC 2018). The Japanese government, as host of the 2019 G20 Summit in Osaka, made good use of this occasion: it successfully passed an elaborate list of “G20 Principles for Quality Infrastructure Investment,” with six pages of text and rather concrete specifications of “quality” (G20 2019).

The final aspect of Japan’s engagement that we need to appreciate is its involvement in the “Free and Open Indo-Pacific” strategy, which the US has supported under President Donald Trump since 2017, when he proposed cooperation toward a “peaceful, prosperous, and free Indo-Pacific” (Trump 2017). While economic cooperation, also in terms of infrastructure, is one aspect of the cooperation of the “Quad” countries, Australia, India, Japan, and the US, it is still not clear what its role will be vis-à-vis the security agenda concerning the PRC. From Japan’s perspective, Shinzo Abe already reiterated his interest in what he calls the four-country “Diamond” in a Project Syndicate article on 27 December 2012, shortly after being elected to his second turn as Prime Minister (Abe 2012). Compared with 2007, he put more emphasis on security, explicitly mentioning the PRC as a concern, and he “invited” the UK and France, both possessing sizable navies, as European countries. He placed additional emphasis on “economic growth” and “Africa” during a 2016 speech in Kenya. Generally speaking, the FOIP is still an aspiration with little substance. The four Quad countries are diverse and do not constitute a naturally stable alliance. Japan’s foreign policy seems to view the FOIP in a “political” context and the PQI in an “economic” one. The PQI is not per se adversarial toward the PRC, although it will be difficult for the FOIP to shake off that image (see also Miller 2019).
Are the approaches of the PRC and Japan complementary, cooperative, competitive, or even confrontational? Some patterns may be discernible by interpreting the international infrastructure arena as a market (Pascha 2020). Based on such an understanding, complex idiosyncratic products (including finance, local real estate, etc.) involving high risk characterize the international infrastructure market, requiring an appropriate ecosystem and often involving various public and private actors. Complexity will rise further because of sustainability issues, the creation of megaprojects, data-driven project development, and novel efficiency potentials (KPMG 2019). One aspect of the complexity is that products often do not have clear definitions but require identification through search and discovery processes first, leading to issues of market creation. State actors become involved for economic reasons, to absorb some risks and to realize positive economic externalities but also to capture political externalities, like reputation and influence, as discussed earlier. Infrastructure markets can also be attractive for governments when it is possible to shift rents to the domestic economy, which is not too unlikely, similar to the strategic trade policy argument (Krugman 2017).

In terms of the supply side, because of such properties, there are usually few suppliers competing for a contract, often involving (national) state actors. On the demand side, there is often a natural monopoly, because, for infrastructure goods like roads or railway lines, only one investment will be able to make economic sense. Compared with the standard textbook case of a supply side oligopoly, the instrumental variables are more complex as well, involving at least the price, contract conditions, and (uncertain) quality. A further complication is that infrastructure typically has the character of an experience good, which leads to issues of trust and reputation. In conjunction with the intransparent complexities of the infrastructure products involved, the market can be prone to rent seeking.

As in oligopolistic markets in general, there is an expectation that the strategies of the limited number of suppliers will very much drive the evolution of such markets, here the PRC and Japan. Given the frequent involvement of potential natural monopolies, clashes of interest are likely and have indeed already materialized. A famous example is the collision of Sino-Japanese interests in the Jakarta–Bandung High-Speed Rail case (Hong 2018). In 2011–3, Japan conducted a feasibility study and estimated the total cost at $6.4 billion, with the expectation of a contribution from the Indonesian government. A competing PRC proposal with $5.5 billion emerged later, based on a 40-year soft loan from the PRC for 40% at a 2% interest rate, and no Indonesian government funds were apparently necessary. Surprisingly for Japan, the PRC won the contract in 2015, although Japan had improved its bid. The rail line is due to open in 2021. Japan reacted, to improve its situation in future cases, with faster government-related procedures by making yen loans available to sub-sovereign entities and by propagating "quality." It is noteworthy that it has adjusted the strategy, in this case, in two ways: on the one hand, through the idea of offering a better "quality" to convince the demand side, and, on the other side, by making more problematic changes. While faster procedures may be welcome at first sight, they could also signal an expectation of the dominance of political will over a careful planning and consideration stage.

Is conflict unavoidable? The PRC’s major competitive advantage is funds, recent current account issues notwithstanding, while Japan’s is know-how and the involvement of experienced private firms. This creates options for cooperation schemes like joint ventures. Indeed, the PRC and Japan have recently agreed on infrastructure cooperation during their October 2018 Summit, mentioning some 50 projects. Different goals and strengths may sometimes be compatible. Another consideration is that the exclusion of the other is often a first best in leadership rivalry, but joining may sometimes be second best (Hamanaka 2018).
There is a danger that competition between two suppliers, who want to enter into business because of underlying political motives, will lead to a lowering of standards and to phenomena associated with ruinous competition. Over the longer term, there is an expectation that the demand side will react to poor quality and contract conditions and take such negative experiences into consideration for future deals, so different paths of market development are conceivable.

An illustrative example is the case of Hambantota port in southern Sri Lanka. Its planning took place under the BRI scheme, but, because of financing problems of the Sri Lankan government, it had to hand over the port to the PRC in 2017 under a 99-year lease. This proved to be a public relations disaster for the PRC, as it seemed to confirm concerns regarding potential debt traps for weaker partner countries as a result of unsustainable and intransparent contracts. The symbolism of a long-term port lease—disturbingly similar to what the PRC had suffered with respect to Hong Kong, China under colonial rule—seemed like a powerful signal supporting those observers who had been critical of the whole concept of the BRI. Nevertheless, the Hambantota port case is merely one step in the longer-term development of infrastructure initiatives. As for Sri Lanka, the PRC has since offered other projects, in particular a $3.9 billion oil refinery close to the PRC-controlled port. In addition, India and Japan seem to be close to signing a major contract to develop a new commercially viable terminal in the port of the capital city of Colombo (Herskovitz and Marlow 2019). Competition in this case possibly leads to better offers for the demand side, raising its consumer rents. This would not be uncommon for similar markets: a case in point could be the development of railways in the US in the 19th century, which provided enormous rents for the users and localities close to the rail lines while jeopardizing the profitability for the railway companies (Wolmar 2012). On a wider scale, concerns about the prudence of the BRI vis-à-vis weaker partner countries and arguably the claim of a quality-oriented alternative that Japan produced have led the PRC to rethink and refine its strategy: during his keynote speech to the Second Belt and Road Forum in April 2019, Xi Jinping mentioned quality aspects as one of three priorities: “We need to pursue high standard cooperation to improve people’s lives and promote sustainable development. We will adopt widely accepted rules and standards and encourage participating companies to follow general international rules and standards in project development, operation, procurement and tendering and bidding” (Xi 2019).

Summing up, during the past years, the PRC and Japan have developed significant initiatives for infrastructure provision in Eurasia and elsewhere. Beyond the significant business, economic, and political implications of concrete projects on the ground level in various countries, these initiatives also have a meaning on the multilateral level in terms of shaping standards of interaction but also in terms of modifying the global and regional frameworks of governance. It should therefore be obvious that European players, including those at the EU level, should react to and be part of these developments. It is both encouraging and challenging to realize that the initiatives of the PRC and Japan, including players in the wider context, like the US or the Quad scheme, for instance, are still evolving and changing rapidly, giving the EU both a large stake and a significant opportunity to influence the developments.
4. THE EU’S ROLE IN THE NEW DYNAMICS OF INFRASTRUCTURE CONNECTIVITY INITIATIVES

This paper will discuss how the EU participates in the new dynamics of infrastructure connectivity initiatives by looking at existing organs, initiatives, and their relationship to the major East Asian initiatives.

For a long period, infrastructure and connectivity have not been a core policy of the EU and of its predecessors. However, during the past 30 years, quite a few institutional mechanisms and initiatives have come into existence that create a basis for the strategic reorientation in this field.

In 1958, the European Economic Community created the European Investment Bank as a policy bank. Over the years, infrastructure has become a “top priority,” with investments in the transport sector of more than 153 billion euros between 2005 and 2015 alone (EIB 2016). While the EIB focuses on intra-EU projects, engagement with partner countries under the umbrella of various initiatives also plays a role.

It is also necessary to mention the European Bank for Reconstruction and Development (EBRD) in this context. While it is not an EU institution like the EIB, a considerable initiative from the EU and major EU member countries established it in 1991 to support the post-Cold War system change in Central and Eastern Europe. The activities of the EBRD include Central Asia and are committed to involving the private sector in fostering change toward market economies. Infrastructure is one of its competencies, with a focus on urban and environmental infrastructure.

As for EU initiatives, four approaches in particular are notable (see a more detailed contextualization in EC-HR 2018):

- The first is the Trans-European Transport Network (TEN-T) policy of the European Commission. It is based on the 1991 Treaty of Maastricht and is concerned with the development of a Europe-wide transport network. For that purpose, it allocated funds to the various budget periods, with additional Cohesion Fund and European Regional Development Fund contributions.

- The second policy line is the European Neighbourhood Policy of the EU, as it relates to its eastern neighbors. The basic idea is to foster deeper relations with those countries nearby that do not have a short-term perspective to join the EU but in which the EU has a significant interest in prosperity, security, and stability. The cooperation has a value-driven component, but it is also concerned with the economic logic of infrastructure networks, which a 2011 Commission Communication entitled “The EU and Its Neighbouring Regions: A Renewed Approach to Transport Cooperation” (EC 2011) explicitly covered, connecting the Neighbourhood Policy to the TEN-T.

- The third relevant context is the EU’s ODA activities. Compared with several other OECD donors, the EU policy has a reputation of being rather value driven. According to the European Consensus on Development, renewed in 2017, principles and values like democracy, human rights, and rule of law are (again) a priority. The Commission proposed to combine ODA and the Neighbourhood Policy in a single instrument during the period 2021–27.

- Fourth and finally, the general external relations context requires consideration. The Global Strategy of 2016 set the framework, referring to “strategic autonomy” for the EU and signaling a strong value-driven agenda: “Our interests and values go hand in hand. We have an interest in promoting our values in the world” (EU
While the Global Strategy contains only a few remarks on particular regions, it does include a short passage on “Connected Asia” (EU 2016, 37–38), stressing that engagement with the PRC should occur on a level playing field and, with respect to Japan, mentioning the intention of a free trade agreement (which in the meantime it has already realized).

Different Directorates General of the Commission plus the External Action Service run the policy fields mentioned above, complicating policy making and coordination. Individual EU member countries also follow their own policies, confusing matters further. In terms of general foreign and security policies, the mandate of the EU-level authorities is particularly weak. Consequently, while European authorities have developed the ingredients for a European-level strategy in the past, as shown above, it comes as little surprise, and has received repeated criticism (e.g., Cameron 2017), that it has been very hard for the EU to formulate a stringent and coherent set of policies toward the region of Asia and its major players.

To some extent, given recent developments, it is necessary to reevaluate this problematic impression, because, in the last two years, the EU has made three important statements in particular that are relevant to the context of Asia-driven infrastructure initiatives: first, the conclusion of the EU–Japan Strategic Partnership Agreement in July 2018; second, the announcement of a new “EU–China Strategic Outlook” in March 2019 (EC-HR 2019), and finally, most importantly here, the Joint Communication “Connecting Europe and Asia: Building Blocks for an EU Strategy” of September 2018 (EC-HR 2018), in the following abbreviated as EACS (Euro Asia Connectivity Strategy).

The evaluation should take place in the light of the challenges that the EU faces in responding to the dynamism of infrastructure initiatives in recent years, as explicated above. The major challenges, condensing them significantly, are the following:

- Many features of the international infrastructure marketplace show properties of an oligopolistic market structure with strong externalities, beyond economics in the field of extra political benefits (influence, etc.), and the possibility of rent shifting. This constitutes a valid case for public involvement, also on a level beyond the national engagement of individual EU member states, making use of the potentially superior market power of the combined EU. The fact that other major players, like the PRC and Japan, are already trying to utilize these opportunities proactively strengthens the case for EU involvement.

- The EU has to consider other major players as well, although they did not feature prominently in the analysis above. Foremost, it must consider the US. The US, Japan, and Australia signed an infrastructure agreement in July 2018, with an MOU in November, possibly involving as much as $1 trillion. However, the small amount of $113 million that the US has actually promised so far seems to support the argument that countries cannot currently regard the US administration as a serious and reliable actor and partner in this field. ASEAN and the Republic of Korea are other important actors in the East Asian context, with which the EU enjoys good strategic relations. Finally, the Russian Federation is yet another important player, which, due to its geographical position in Eurasia and its links in the region, is hard to avoid in Euro-Asia connectivity schemes. The current sanctions, imposed since 2014, imply considerable opportunity costs for the creation of meaningful connectivity cooperation across Eurasia.

- More generally, there is the demanding challenge of making the value-driven agenda of the EU—in terms of democratic and sustainability norms in particular—
conform to the more self-interested, but legitimate, economic, business, and political concerns that it has to pursue for the benefit of its members.

- To achieve a noticeable impact in the Euro-Asia connectivity and infrastructure field, a sizable contribution to overcoming the identified financial gaps is necessary.

- Finally, connectivity and East Asian infrastructure initiative issues concern not only faraway places but the area of the EU itself and of potential new EU members. The PRC has developed closer connections with 16 Central and Eastern European (CEE) countries since 2012, and with Greece since 2019, making it a 17+1 scheme, encompassing 12 members of the EU plus five states in the Western Balkans. The cooperation has achieved noteworthy results in terms of trade expansion and increased direct investment for at least some of the 17 countries. The PRC has set up a PRC–CEE investment fund and endowed it with 10 billion euros. There are concerns (for a summary, see Stanzel 2016) about whether such a cooperation might lead to projects not conforming with or even undermining EU guidelines and standards and whether EU members could become too lenient when other members feel that they should criticize the PRC for political reasons. It is notable that the group of 17 is not very cohesive, with the members competing against each other for the PRC’s attention. However, most of the concerns mentioned previously do not depend on the cohesion of the group but work on the level of individual states. In 2019, Italy, as a core EU member, signed an MoU with the PRC’s BRI, raising similar reservations. It is indeed noteworthy that the weaker states of the EU and the Western Balkans seek this kind of cooperation, while they are the ones that are the most vulnerable to problematic incentives. Finally, Japan’s Prime Minister Abe announced a Western Balkan Initiative during a six-day visit in 2018 (Mlloja 2018), clearly reacting to the PRC’s activities.

To what extent do the three major statements and policy decisions mentioned above, on Eurasian connectivity, on the PRC, and on Japan, relate to these challenges? The EACS set out to explain and praise a “European way” of “sustainable, comprehensive and rules-based connectivity” (EC-HR 2018, 2–3), which it recommended for the engagement with Asian partners, together with the mobilization of additional (financial) resources. Whether there is truly a “European way of connectivity” seems to be rather unlikely. However, enlisting various mechanisms for mobilizing financial resources, particularly in the context of a “new external investment architecture,” is meaningful, although details about concrete allocations or quantitative goals are missing. The EACS continued by listing specific issues and key actions in transport, digital connectivity, energy connectivity, and people-to-people connectivity, the latter including education exchange.

The proposals include sensible endeavors, like connecting the TEN-T framework with networks in Asia. Some of these actions are already underway, however. For instance, there was a previous agreement to extend the TEN-T to six Eastern European and Central Asian countries, namely Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine. In that respect, the EACS rather seems like a summary of policies of various parts of the Commission and of the External Action Service, without constituting a forceful and consistent reorientation. It lists various fields and the various EU initiatives in those fields under the headlines of air, sea, and land transport, digital connectivity, energy connectivity, and people-to-people connectivity. The lofty claim of a “European way” does not substitute a strategic vision. Another feature, which fits this characterization, is that it largely leaves out controversial topics and thus remains indeterminate. For instance, the short paragraph on energy connectivity does not even touch on the grave problems of how to position the EU with respect to receiving gas from
across Eurasia and through various (potential) routes, how to handle problematic actors like the Russian Federation in this context, and how to balance economic–strategic interests and European values. In this context, research has established well that the EU’s self-interest, namely its energy needs and the perceived energy security threat, mainly drive its strategic interest in Central Asia (e.g., Proedrou 2012).

The PRC and Japan appear rather prominently in the chapter on bilateral cooperation. In both cases, it mentions aspects of cooperation and coordination in an engaging way. In the case of the PRC, however, it records the potentially controversial issues of market access and a level playing field as important European positions. The March 2019 EU–China Strategic Outlook pointed out the position of the PRC as a partner but also as a competitor and even as a systemic rival even more clearly. For connectivity, this means that, on the one hand, people see the PRC as a valuable partner in finding fruitful configurations for connectivity across Eurasia. The EU–China Connectivity Platform, set up in 2015, serves this purpose. On the other hand, noting issues in the 16+1 (now 17+1) framework, the Western Balkans, and elsewhere, the EU intends to use its instruments “more robustly” to “preserve its interest in stability, sustainable economic development and good governance” (EC-HR 2019, 5). As for Japan, the EACS mentioned reinvigorating the EU–Japan transport dialogue and, more importantly, the need to “coordinate closely efforts to promote international standards and regional cooperation in Asia” (EC-HR 2018, 7). In terms of standard setting for international infrastructure projects, the EU thus sees Japan as an ally, sharing similar interests, while it views the PRC rather as a competitor. Such cooperation is already visible with respect to the G20 meeting in June 2019 in Japan. The 2018 EU–Japan Strategic Partnership Agreement does not mention infrastructure cooperation and connectivity, but the reference to multilateral, development, and industrial cooperation (Articles 10, 11, and 17) easily allows for such a focus.

Summing up, the EACS of 2018 still lacks rigor and a persuasive strategic vision in several respects, while it has already started to shape the way in which the EU sees its role in the ongoing evolution of East Asia-driven infrastructure initiatives. It is understandable, though still regrettable, that the Commission and the External Action Service have not yet ventured further at this point in time: the major inhibiting factors are that member countries follow their own policies, which are possibly to some extent at odds with the EU level and among themselves, a new Commission will take up office after the European Parliament elections in May 2019, and the budget framework for 2021–2027 has not passed yet, with Brexit and the budgetary issues following it making foresight even more problematic.

Before deriving policy recommendations for the future, there should be some stock taking of the main findings of this paper on which to base the recommendations.

5. CONCLUSIONS AND POLICY RECOMMENDATIONS

The paper set out to analyze the growing importance of infrastructure connectivity initiatives in recent years, which East Asian players, the PRC, and Japan in particular have largely driven. While both countries are following a wide range of projects as part of different policy lines, it is possible to interpret the BRI and the PQI as notable flagship projects that deserve special attention. The BRI is a major infrastructure initiative that started in 2013 with the proposal of a so-called “belt” across Eurasia with three routes and a maritime “road” with two routes. Besides infrastructure in a narrow sense, it covers policies, trade, finance, and people connectivity. In the meantime, the proposal has evolved considerably, for instance in terms of covering more regions than Eurasia. The
Japanese PQI in 2015 started as a regional infrastructure initiative for Asia in 2015, but it quickly turned toward the world at large in 2016. Its major proposition rather regards content, namely to promote so-called “quality” infrastructure. The EU has been active in infrastructure investment for a long time, including beyond its boundaries, for instance through the EIB. It only spelled out an explicit policy toward Asia in 2018. It is rather a summary of existing policies in various fields that will intensify vis-à-vis Asia, namely transport, digital connectivity, energy connectivity, and people-to-people connectivity.

Infrastructure is an important growth sector for the global economy, while there are considerable financial gaps. An initiative like the BRI makes sense for the PRC, because, despite the public good properties of such an initiative, it serves the interests of the PRC as an aspiring regional and possibly global leader, trying to make an impact on the multilateral order as well. As an incumbent major player in the region, Japan followed with its own initiative, the PQI. Both concepts are continuously evolving, and framing infrastructure as a market was helpful in understanding the dynamics better: in an oligopolistic market, suppliers will frequently react to each other, and temporary outcomes are less meaningful than adaptation and learning. Conflicts may occur, but cooperation is also possible; for both, there are already empirical cases. Regarding Japan, which cannot compete with the PRC on price, promising infrastructure “quality” and safeguarding it through multilateral agreements was a smart move.

The EU has not been a major player in the international infrastructure arena for a long time. Still, it cannot avoid taking a stance in that field: infrastructure is an important current and future market for the EU as well, and Eurasian connectivity, the original focus of the BRI, touches its vital interests. The impact of the BRI is very apparent in the 17+1 framework and the PRC’s interest in the Western Balkans, Italy, and elsewhere.

In recent years, the EU has already become more active, particularly by trying to synchronize and push forward relevant policies in the 2018 Joint Communication on Connecting Europe and Asia: Building Blocks for an EU Strategy. While it still lacks some rigor and a persuasive strategic vision, it already encompasses important policy proposals with which the EU takes a more active position in the ongoing evolution of infrastructure initiatives. Examples include measures to mobilize additional financial resources and extend the Trans-European Transport Network toward Eurasia, even if not all the proposals are entirely new. The EU sees Japan as a partner in setting up and safeguarding multilateral standards, while it views the PRC both as a partner and as a rival, which needs to respect a level playing field.

To sharpen its policies further, the EU should consider further measures that

- increase the leverage of EU policies on infrastructure connectivity with Asia beyond its own budgetary means, and
- are in line with its self-proclaimed objectives, which include sustainability, comprehensiveness, rule-based mechanisms, openness, transparency, and good governance (EC-HR 2018, 2–3).
It is beyond the scope of this paper to develop policy proposals systemically based on these fundamental considerations and in line with feasibility constraints, related to the various dimensions of infrastructure connectivity, the organizational structure of the EU, and its relationship with the business community and with potential external partners. Still, it is important to consider the following points, concentrating on institutional matters:

- Financing infrastructure will be a major challenge for all global players in view of the identified gaps. The 2018 Communication underlines this but lacks a concrete roadmap. The EU should sharpen the strategy in the not-too-distant future while allowing for flexible reactions to what happens elsewhere. The European Commission’s Investment Plan for Europe, known as the “Juncker Plan,” was a major effort from 2015 to 2017. The incoming Commission should consider something similar for infrastructure, with a global perspective including Eurasia.

- Given the ambiguities of oligopolistic competition for major infrastructure projects, multilateral rules for environmental and social standards as well as for fair competition and good governance of projects are extremely important, both in their own right and because EU industry cannot win a competition race based on price and (lower) contract conditions. Japan is a natural ally to support this position jointly in regional and multilateral fora, like the G7, the G20, and the OECD. There is considerable scope for further EU–Japan connectivity cooperation under the umbrella of the Strategic Partnership Agreement to support common interests. The bilateral “Partnership on Sustainable Connectivity and Quality Infrastructure,” signed in September 2019, is an important step in this direction, which it is now necessary to activate (EU and Japan 2019). One obstacle to developing a more focused EU strategy is that member countries follow their own policies in view of their respective industrial interests. The Commission and its several Directorate Generals and the External Action Service should therefore closely and persistently coordinate themselves and work with members that have a strong position in the infrastructure market. A joint task force of the EU, national authorities, and business interests may be helpful as an organizational frame.
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