

# MOBILIZING THE INDO-PACIFIC INFRASTRUCTURE RESPONSE TO CHINA'S BELT AND ROAD INITIATIVE IN SOUTHEAST ASIA

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## EXECUTIVE SUMMARY

China has become a significant financier of major infrastructure projects in Southeast Asia under the banner of its Belt and Road Initiative (BRI). This has prompted renewed interest in the sustainable infrastructure agenda in Southeast Asia from other major powers. In response, the United States, Japan, and Australia are actively seeking to coordinate their own revamped overseas infrastructure efforts as part of a trilateral arrangement aimed at upholding a free and open Indo-Pacific.

Though principally motivated by geostrategic concerns, such international policy efforts are also well-justified on economic grounds – given the persistence of Southeast Asia's large infrastructure financing gap, low world interest rates, and concerns about structurally weak global economic growth. In addition, China's approach to infrastructure poses clear risks to governance, as well as economic, environmental, and social sustainability in the region. Finally, at the time of writing, the COVID-19 virus has unleashed a global health and economic pandemic of enormous proportions. Policymakers are currently focused on containing the health and economic damage of the virus. However, as the priority shifts to the post-crisis recovery, this inevitably will see focus return to the sustainable infrastructure agenda – with Southeast Asian governments looking for willing partners to assist.

The current approach of the trilateral partners, however, is likely to fall short in its ambition to provide a credible response to China's BRI. The present emphasis on mobilizing more private capital for infrastructure development cannot deliver the kind of dividends needed to compete with the scale of China's BRI. Nor is an emphasis on high infrastructure standards likely to deter Southeast Asian governments from taking on Chinese projects as long as China continues to be perceived as offering faster, less risk-averse, and more responsive support compared to alternatives available from traditional partners.

This policy brief makes several practical recommendations that would allow the trilateral partners to compete more effectively with China while simultaneously promoting more sustainable development outcomes. This includes increasing efforts to expand the pool of bankable projects and providing technical assistance to help Southeast Asian governments to better manage any BRI projects they might take on – particularly via the multilateral development banks, which can act as politically neutral technical arbiters. Meanwhile, the trilateral partners need to improve the competitiveness of their own infrastructure approaches to be more streamlined, less risk-averse, and more fit-for-purpose. This could be a useful part of the agenda for the new Blue Dot Network. More ambition is also needed. Contrary to the assumption that it is impossible to match China's financing scale, estimates presented in

this policy brief suggest that the gap is not that large — implying the trilateral partners can indeed keep pace if they are willing to direct adequate budgetary resources to the task. Finally, Australia is currently the only trilateral partner without access to the full range of development financing instruments and should consider options for addressing this gap in its capabilities.

## INTRODUCTION

The sustainable infrastructure agenda in Southeast Asia has taken on increased prominence in recent years. China's Belt and Road Initiative (BRI) promises a major increase in available funds to help plug the global infrastructure financing gap, including in Southeast Asia. It has also made international infrastructure efforts vastly more contentious. Early enthusiasm from governments participating in BRI has been replaced with greater caution about the risks. At the same time, there is much geopolitical angst, particularly in the United States, about the role of BRI as a form of economic statecraft intended to enhance China's influence through state-directed investment and the creation of a more Sino-centric regional order.

This has prompted the United States, as well as Australia and Japan, to respond with their own revamped overseas infrastructure endeavors, including a new Trilateral Partnership for Infrastructure Investment in the Indo-Pacific aimed at coordinating their individual efforts.<sup>1</sup> The primary approach of the trilateral partners is to catalyze more private capital into sustainable infrastructure investment through the use of "blended finance" — using official capital from governments to leverage in private investment.

The key question is: How effective will an approach focused on mobilizing private infrastructure investment be in either competing with BRI or meeting Southeast Asia's financing needs? This policy brief first describes the infrastructure scene in Southeast Asia and the emerging Indo-Pacific infrastructure strategy of Australia, Japan, and the United States (henceforth, the trilateral partners). It then discusses key infrastructure trends and

challenges in Southeast Asia and the prospects of the current trilateral strategy to successfully mobilize significantly more private capital for infrastructure investment. Finally, it puts forward policy ideas for how the trilateral partners might simultaneously promote better development outcomes while responding more effectively to China's growing infrastructure financing role in the region and bolstering their own position.

Though driven by geopolitics, it is vital to recognize that enhanced international policy efforts to channel more capital into infrastructure in Southeast Asia are justified on economic grounds. A large and persistent shortfall in infrastructure investment in the region is a major risk to its future growth prospects and warrants attention — including from external players with an interest in the region's ongoing growth and stability. In addition, the economic case for such investment is made considerably stronger by the presence of persistently low interest rates in most advanced economies. This not only greatly reduces the cost of funding more growth-enhancing infrastructure, but also means that such investment could make an important contribution to providing a much-needed boost to global demand and growth.<sup>2</sup> Seeking to mobilize more private capital also has its merits, as official capital alone could never plug the infrastructure financing gap and there is plenty of (notional) market interest. Finally, the economic pandemic unleashed by COVID-19 only reinforces the importance of the sustainable infrastructure agenda — as a means of supporting the post-crisis recovery and as world interest rates have moved even lower and are likely to remain there for some time.

## BRI AND THE EMERGING INDO-PACIFIC INFRASTRUCTURE RESPONSE

Sustainable infrastructure development is a critical development priority for Southeast Asia. The Asian Development Bank (ADB) has estimated that the region faces an annual financing gap of 3.8-4.1% of GDP or \$92-102 billion in constant 2015 prices.<sup>3</sup> Closing the infrastructure financing gap will be essential to not only sustaining Southeast Asia's ongoing economic rise, but also to the need for substantial new investments related to climate change mitigation and adaptation.

China's BRI, first launched in late 2013, ostensibly offers to help meet this financing gap. Southeast Asia is home to flagship BRI investments, including the China-Indochina Peninsula Corridor and the Bangladesh-China-India-Myanmar Economic Corridor, as well as large projects such as the East Coast Railway Link (ECRL) in Malaysia and the Jakarta-Bandung high speed railway project in Indonesia.

However, many high-profile BRI projects have encountered difficulties due to concerns about the impact on sustainability and openness in the region. The fundamental problem afflicting many BRI projects has been a lack of upfront due diligence – in terms of engineering design, economic and financial viability analysis, and environmental and social safeguards – with the result being that many BRI projects have often simply traded speed early in the project cycle for more difficult problems later on.<sup>4</sup> Tied financing (requiring the use of Chinese contractors) and opaque practices have also been associated with cost blow-outs and corruption scandals, most infamously in the case of the ECRL project in Malaysia. These problems have raised concerns, particularly in Washington and other Western capitals, that BRI could contribute to an erosion of fair and open competition, good governance, and economic, environmental, and social sustainability in Southeast Asia (and elsewhere).

In response, Australia, Japan, and the United States have joined together to form a Trilateral Partnership for Infrastructure Investment in the Indo-Pacific. The principle aims are to jointly finance major projects in the region and to coordinate promoting sustainable infrastructure development according to global “high standards” – particularly good governance, open procurement, debt sustainability, and environmental and social safeguards. The new trilateral arrangement is in turn underpinned by actions taken by each partner to enhance their own overseas infrastructure financing capabilities. In particular:

- Australia has revamped its export credit agency, renamed Export Finance Australia, giving it a much wider remit to finance overseas infrastructure projects deemed to be in the broad national interest and substantially increasing its capital base by \$1 billion Australian dollars to about AU\$1.7 billion, a roughly 150% increase.<sup>5</sup> Australia has also established an AU\$2 billion infrastructure financing facility and acquired the ability to effectively provide concessional loans to focus on South Pacific countries, though Timor-Leste will also have access to these developments.<sup>6</sup> Australia also plans to put in place a new aid-funded technical advisory facility to support infrastructure development in the region.<sup>7</sup>
- The United States has transformed its Overseas Private Investment Corporation (OPIC) into a new International Development Finance Corporation (IDFC) with modernized financing capabilities, including the ability to provide equity financing, local currency loans, and guarantees. Also, the United States doubled its total funding portfolio ceiling to \$60 billion.<sup>8</sup> The United States has also allocated \$113 million to provide technical assistance and advisory support to facilitate greater private infrastructure investment.<sup>9</sup>

- Japan launched its Expanded Partnership for Quality Infrastructure in 2016, which seeks to target over \$200 billion in global infrastructure financing over five years to be delivered primarily through the Japan Bank for International Cooperation (JBIC) and the Japan International Cooperation Agency (JICA) as well as “Japan-wide” efforts that incorporate other policy-based financial institutions.<sup>10</sup>

Through these coordinated initiatives, the trilateral Indo-Pacific partners aim to mobilize private capital for regional infrastructure investment, promote sustainable infrastructure development according to global “high standards,” and balance China’s growing geopolitical influence by providing a competitive alternative. Most recently, the trilateral partners have launched the Blue Dot Network as a multi-stakeholder initiative to evaluate and certify nominated infrastructure projects according to high quality principles and standards.<sup>11</sup> Further new initiatives may well follow.

## INFRASTRUCTURE FINANCING TRENDS AND CHALLENGES IN SOUTHEAST ASIA

The additional resources promised by the trilateral partners are welcome, as is the focus on mobilizing greater private investment. Infrastructure has been growing rapidly as a global asset class, having tripled over the past decade to \$420 billion in total assets under management.<sup>12</sup> With the holdings of institutional investors estimated at \$100 trillion, there is notionally considerable scope to go much further.<sup>13</sup> This is particularly so, as low global interest rates fuel a search for yield among investors. For investors, infrastructure assets offer the potential for diversification, steady cashflows, and predictable real returns over long time horizons that match well with the needs of institutional investors (e.g. pension, insurance and sovereign-wealth funds). For official financiers, involvement from private investors can help to manage different risks and deliver better quality projects.

Supply-side constraints, however, mean that crowding in substantial amounts of additional private capital for infrastructure has been an elusive “holy grail” of development finance for some time. The constraints to greater private investor involvement are well-known, including political and macroeconomic risks, corruption, project implementation risks, and problematic legal and regulatory frameworks. These combine with the lower incomes of developing countries to reduce the risk-adjusted returns on offer for investors. The challenge also reflects more technical, though not unrelated, issues, including the lack of well-prepared “bankable” projects, shallow domestic capital markets, and limited country knowledge among potential investors. The World Bank tracks infrastructure projects in developing countries around the world that involve private participation.<sup>14</sup> According to the World Bank, such private participation in infrastructure (PPI) investment has averaged about \$110 billion a year over the past decade – providing one-fifth of total investment, or just 13%, of the amount required.<sup>15</sup>

Blended-finance efforts have struggled to crowd in greater private infrastructure investment in the developing world, at least compared to the scale required. For infrastructure projects benefitting from blended finance, the average ratio of private capital “leveraged” per dollar of official finance appears to be in the range of 0.8-1.8.<sup>16</sup> These leverage ratios, however, over-estimate the true degree of additionality (i.e. that which would not have otherwise occurred) and are in any case well below the degree hoped for given the scale of the infrastructure financing gap.

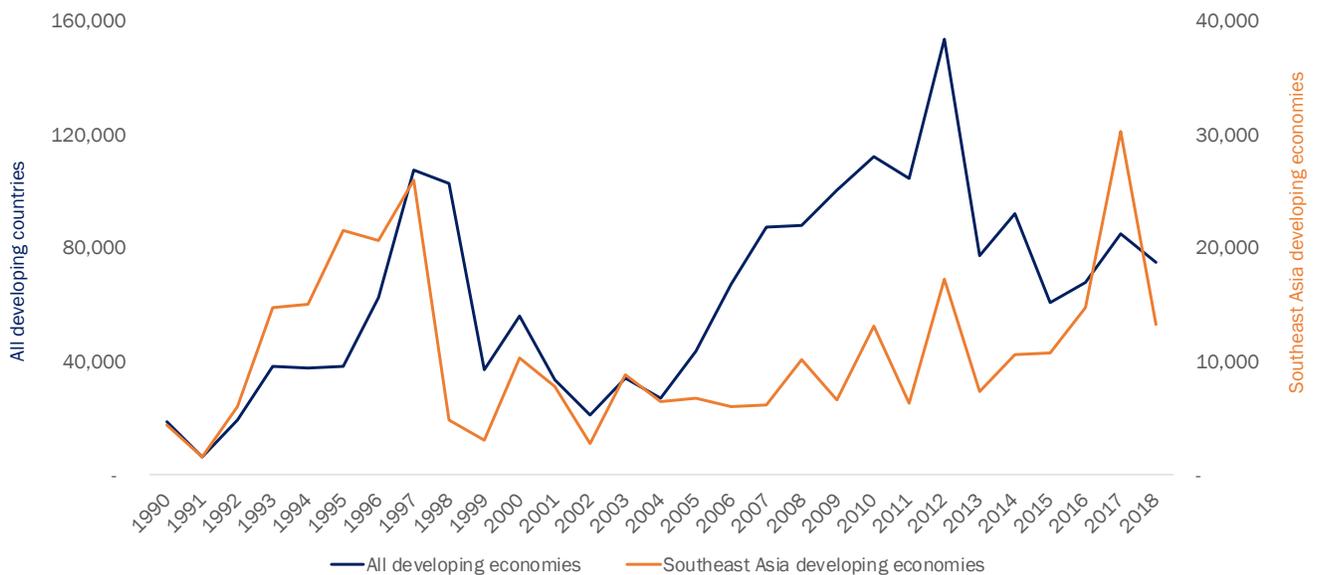
Overall, the trend in PPI investment across the developing world has been mixed at best – rising during the 2000s but in decline more recently and still below that in the late 1990s (Figure 1). This performance is all the more inadequate given ongoing growth in the demand for infrastructure services due to increases in population, urbanization, and economic activity. Further, two-thirds of this investment has flowed

to upper-middle income countries rather than less developed countries where the needs are more acute. The ability to attract private financing has also varied enormously by sector, with power and information and communications technology infrastructure generally more successful, while urban infrastructure – including roads, water, and

sanitation – has proven more difficult.<sup>17</sup> In terms of the promise of institutional investor involvement, this has proven largely elusive, with the World Bank finding this provided just 0.7% of private infrastructure investment in the developing world from 2011-2017.<sup>18</sup>

**FIGURE 1: LIMITED PROGRESS LIFTING PRIVATE PARTICIPATION IN INFRASTRUCTURE INVESTMENT**

Total PPI investment value (USD millions, constant 2015 prices)



Source: Author’s calculations based on World Bank Private Participation in Infrastructure database

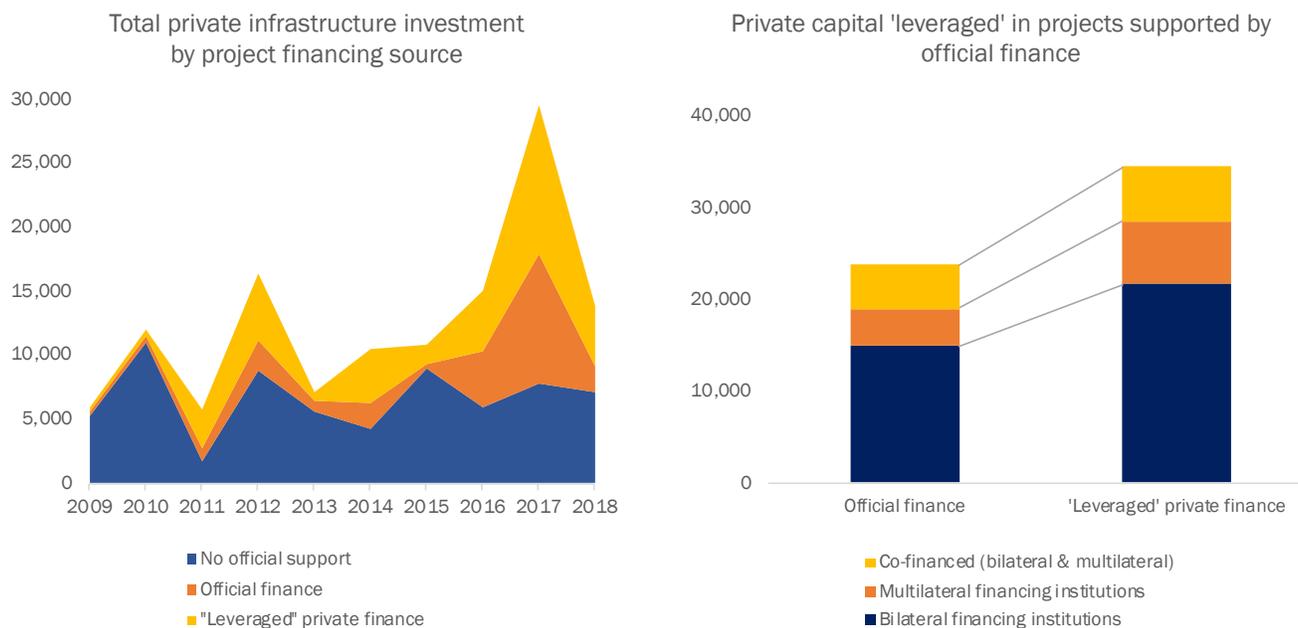
Emerging Southeast Asian economies might seem to offer greater scope for success but in practice appear to largely confront the same constraints as elsewhere. Relative political stability, more dynamic economies, burgeoning pools of urban middle-class consumers, and growing domestic capital markets all mean that Southeast Asia ostensibly offers stronger prospects for leveraging more private capital into infrastructure investment. Yet, overall progress in encouraging greater private infrastructure investment has been disappointing. Total PPI investment amounted to \$129 billion over the past decade for developing Southeast Asian economies (i.e. excluding Singapore and Brunei).

To put in perspective, such investment was \$10.8 billion in 2015, compared to ADB estimates of the current level of infrastructure investment in Association of Southeast Asian Nations (ASEAN) countries of \$55 billion in the same year and total required annual investment of \$147-157 billion. That suggests infrastructure investment involving the private sector accounts for only about one-fifth of actual investment or around 7% of the total needed. From 2011-2017, the World Bank can only identify three projects with direct participation from institutional investors with a total investment value of just \$2.4 billion from all sources.<sup>19</sup> Nor is the

trend in PPI investment any better than elsewhere in the world, having collapsed after the Asian financial crisis, only recently beginning to recover, and still well below the levels of the mid-1990s in real terms (Figure 1).

Official finance has played a big role in the recent recovery in private infrastructure investment in Southeast Asia but appears no more successful in mobilizing private capital than elsewhere. Figure 2 breaks down the World Bank data to examine the financing sources of PPI investment in Southeast Asia over the past decade. As shown in the left-hand panel, the entire improvement in investment in recent years can be accounted for by projects benefiting from official multilateral and bilateral support – both in terms of direct financing from official agencies as well as “leveraged” private capital.<sup>20</sup> Of note, the majority of official support reflects bilateral, rather than multilateral, financing (Figure 2, right-hand panel). Most bilateral financing support has come from just two sources: Japan and China. The ratio of private capital leveraged per dollar of official finance over the past decade in Southeast Asia has been 1.5 – suggesting no better success in mobilizing private capital than in other parts of the developing world.<sup>21</sup>

**FIGURE 2: THE RECENT IMPROVEMENT IN PRIVATE INFRASTRUCTURE INVESTMENT IN SOUTHEAST ASIA REFLECTS INCREASED BLENDED FINANCING (USD MILLIONS, 2009-2018)**



Source: Author's calculations based on World Bank Private Participation in Infrastructure database

Moreover, the true additionality of this leverage is less than it seems, with signs that private capital is being crowded out. A limited pool of bankable projects means increased official financing may be crowding out private investment that might otherwise have financed the same projects. There are signs this is occurring. For instance, it is notable that the level of PPI investment not receiving official financing support has been flat over the past decade and has only marginally increased since the early 2000s. This is despite progress by Southeast Asian economies in improving their macro-financial stability, strengthening policy and institutional frameworks, and maintaining fast economic growth — though crowding out by domestic state sectors is also a key factor.

Another sign of bilateral financing crowding out private investment can be seen by examining infrastructure projects supported by the multilateral development banks. These tend to be projects where the multilaterals are heavily involved in project preparation and structuring transactions. Projects supported only by the multilaterals have realized an

average leverage ratio of 1.7 dollars in private capital per official dollar over the past decade. However, where projects also attract bilateral financing support, this has tended to result in a much lower overall leverage ratio of 1.2.<sup>22</sup> It is possible that these projects were less financially viable than others and therefore in need of greater official sector support. However, compared to the overall portfolio of projects supported by the multilaterals, a disproportionate majority were located in the relatively large and more developed markets of Indonesia and Thailand as opposed to smaller, less developed countries where one would expect the need for official sector support to be greater.

These realities point to the challenge of lifting private infrastructure investment in Southeast Asia given the fundamental supply-side constraints that result in a limited pool of bankable projects. The provision of more technical assistance to assist with reform, project preparation, and transaction advice is one solution that the trilateral partners are pursuing through various new and existing mechanisms. This can surely help.

However, scaling up such efforts is unlikely to unlock significant new pools of bankable infrastructure projects. For instance, recent independent evaluations of the World Bank Group have found that upstream policy reform work failed almost half the time due to political complications and that downstream project structuring and transaction advice had not markedly increased the number of bankable projects.<sup>23</sup> Project preparation facilities appear to have had some success, at least in Asia, and have been expanded, for instance through the establishment of the multi-donor Asia Pacific Project Preparation Facility at the ADB.<sup>24</sup> Nonetheless, these efforts have so far had at most a marginal impact on the overall volume of bankable projects coming through, as can be seen in the disappointing trend in total private infrastructure investment, particularly for that not receiving bilateral financial support.

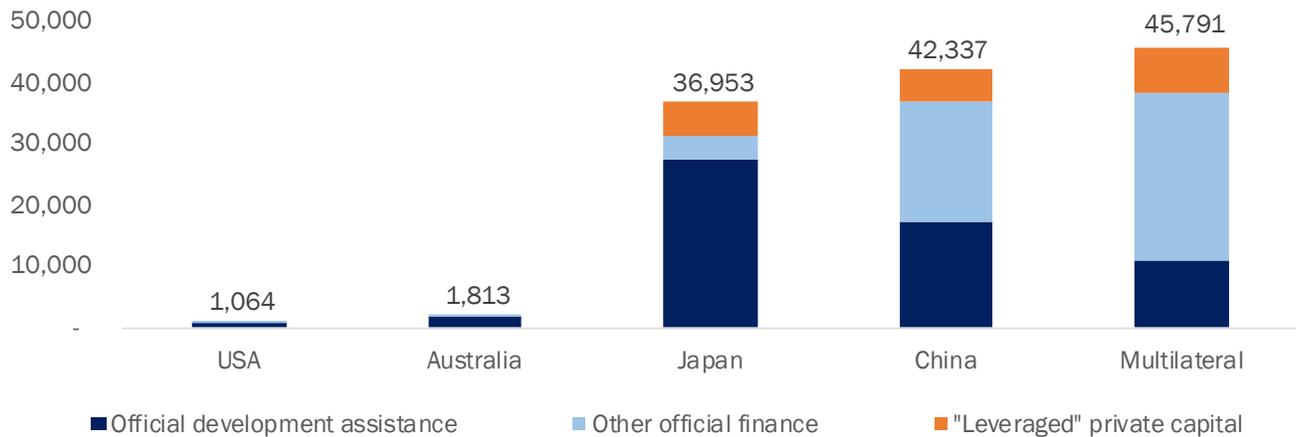
The difficulty of addressing supply-side constraints poses important challenges and tensions for the agenda of the trilateral partners. If the pool of bankable projects cannot be significantly enlarged, then there is a risk that expanded official financing from the trilateral partners will increasingly suffer from crowding-out effects – resulting in reduced additionality in terms of overall infrastructure investment. It would also go against the stated desire of the trilateral partners to promote open competition following market-based principles. This is especially the case since the trilateral partners have chosen to pursue their enhanced overseas infrastructure efforts primarily through financing

mechanisms that largely continue to preference their own firms – i.e. “tied financing” not entirely dissimilar to that practiced by China under BRI. This approach not only undermines the claim of the trilateral partners to be promoting market-based competition but will also likely result in weaker economic and developmental benefits for countries receiving the investment – relative to a truly market-based approach – through higher costs, sub-optimal project selection, and more difficulty in balancing the conflicting interests of project firms and national governments (e.g. in terms of financial risk-sharing and infrastructure regulatory settings).

Limited prospects for leveraging significant amounts of additional private capital also has important implications for the ability of the trilateral partners to compete with China’s scale. Thus far, the United States and Australia are primarily trying to compete in Southeast Asia by leveraging private capital into their own bilateral efforts, rather than responding with a large increase in their own financing. Only Japan has taken a more ambitious approach in combining leveraging efforts with a scaling-up of its already significant overseas infrastructure financing activities. What are the prospects of meaningfully competing with Chinese scale through the current strategy? Getting a sense of the scale of official infrastructure financing from various players is difficult, especially given the opacity of China’s overseas financing activities. Figure 3 combines data from multiple sources to shed light on this question.

### FIGURE 3: COMPETING WITH THE SCALE OF CHINA'S INFRASTRUCTURE FINANCING IN SOUTHEAST ASIA

Total financial commitments by official sponsor (USD millions, constant 2015 prices, 2008-2016)



Notes: Figures are compiled based on multiple data sources while removing projects that appear in more than one data source. For China, this is based on ODA-like flows according to AidData. "Leveraged" private capital is based on the World Bank PPI data, which records foreign state-owned enterprises as private firms.

Source: Author's calculations based on World Bank Private Participation in Infrastructure database, OECD Creditor Reporting System, and Custer et al (2018)

China has overtaken Japan to become the largest bilateral infrastructure financier in Southeast Asia. From 2008-2016, China's financial commitments for infrastructure projects totaled \$42 billion compared to \$37 billion for Japan. The available data only allows us to compile estimates on total official infrastructure financing to 2016. From then on, China's BRI appears to have lost some momentum while Japan's expanded efforts have been gathering pace. Nonetheless, the available data suggests the overall trend has remained intact – with the PPI data extending to the second half of 2019 showing that official infrastructure financing from China continues to outpace that from Japan. Note, this is a very different picture to that suggested by oft-cited estimates compiled by the ratings agency Fitch, which put Japan ahead of China. For our purposes, the Fitch numbers seem questionably large and appear to go well-beyond projects receiving official financing support to include projects that might merely involve Japanese and Chinese firms as commercial investors or contractors without any direct financial support from their home governments.<sup>25</sup>

Returning to Figure 3, not only has China overtaken Japan in terms of official infrastructure financing, but it has also provided more financing than the trilateral partners combined – owing to the very minor financing roles played by Australia and the United States. Moreover, China is also closing in on the total scale of financing being provided by all multilateral institutions combined. Finally, Figure 3 makes clear that leveraged private capital plays only a minor role. Instead, direct financing, including from explicitly concessional sources, plays the dominant role.<sup>26</sup>

The outlook for the future is heavily clouded by the uncertain economic impact of the COVID-19 pandemic, particularly in terms of its differential impact on the economies of the trilateral partners, China, and Southeast Asia. However, on pre-existing trends, the ability of the revamped trilateral infrastructure efforts to compete with China's BRI would appear quite uncertain. Recent enhancements to the overseas infrastructure capabilities of Australia and the United States should see some expansion in their financing activities in the region. Yet, any setback to BRI's continued

expansion could prove temporary. China as looks to respond to recent criticisms and lift its standards. That could mean a slower pace of expansion for BRI going forward, especially if it involves greater project due diligence and selectivity. Nonetheless, China will likely continue to eschew the kind of risk-averse and time-consuming standards employed by both the trilateral partners and multilateral institutions. To the extent China continues to be perceived to offer faster, less risk-averse, and more responsive infrastructure support, it is likely to continue to find plenty of willing takers in Southeast Asia — where most governments are fiscally constrained, are struggling to attract sufficient private capital inflows, are relatively comfortable with state-led investment, and are keen to further integrate their economies with China’s and capture relocating industrial supply chains.<sup>27</sup>

## **POLICY RECOMMENDATIONS FOR THE TRILATERAL PARTNERS**

### **1. The trilateral partners should take active steps to minimize crowding out and the risk of an overly mercantilist approach.**

Thus far, the trilateral partners have put much more emphasis on financing new infrastructure projects than on increasing the pipeline of bankable projects. Despite the limitations noted earlier about what results can realistically be expected, at minimum there should be a commensurate increase in efforts to expand the pool of bankable projects to minimize crowding-out effects and align with the trilateral partners’ emphasis on market-based, rather than state-backed, competition. Similarly, the trilateral partners should articulate clear policies prioritizing the sustainable development of Southeast Asian economies over any mercantilist interests. That should involve a strong commitment to untied financing and ensuring projects are structured to prioritize the development interests of partner countries rather than home-country firms.

### **2. The trilateral partners should increase technical assistance, including via the multilateral development banks, to help Southeast Asian governments consider and manage BRI projects.**

Governments in the region are well aware of the risks involved with BRI. But a lack of technical capacity is often a constraint in mitigating these risks and putting in place more favorable arrangements. Tactfully deployed technical assistance could help Southeast Asian governments lift the standard of any BRI projects they take on. To some extent, this can be done through carefully managed bilateral facilities operating under the public radar. A more politically neutral (and therefore more scalable) approach would be to work through the multilateral development banks — including the ADB, World Bank, and even the China-led Asian Infrastructure Investment Bank (of which Australia is a member, though not Japan or the United States). These institutions already house infrastructure advisory facilities receiving China’s financial support and recently signed a joint memorandum of understanding with China’s finance ministry to establish a cooperation platform. By contrast, the recently announced Blue Dot Network is unlikely to have much impact on raising the standard of BRI projects, as these will likely remain outside the network as long as it is perceived as a U.S.-led effort to counter BRI.

### **3. The trilateral partners should not only focus on high infrastructure standards, but also strengthen existing approaches to be more streamlined, less risk-averse, and fit-for-purpose — including via the Blue Dot Network.**

The current focus of the trilateral partners on “high standards” risks proving ineffective in competing with China’s BRI while paying too little attention to important shortcomings in existing international standards and approaches. While the emphasis on “high standards” is intended to lead to better quality and more sustainable projects, developing country governments, including in Southeast Asia,

have tended to see this as resulting in slow and burdensome processes and excessive risk-aversion – particularly with regard to the multilateral development banks and in more difficult and fragile environments. Persistent efforts to streamline processes and strike a better balance between managing risk and delivering results are needed. This could provide a useful agenda for the Blue Dot Network in developing common approaches to learning from the experience of national, bilateral, multilateral, and private financing institutions, as well as civil society. This would involve shifting the network towards emphasising fit-for-purpose approaches in addition to promoting “high standards.”

#### **4. The trilateral partners should scale up official financing, including aid, to both support greater regional prosperity and keep pace with China as an infrastructure financier for the region.**

Contrary to frequent assertions that the West cannot compete with China’s financing scale, the figures compiled in this brief show that the trilateral partners already provide almost as much infrastructure financing as China. Moreover, the majority of this comes from aid budgets rather than non-aid sources. Currently, each of the trilateral partners allocates around 0.2% of Gross National Income to official development assistance, well below around the 0.5% among many European governments.<sup>28</sup> Moving to the OECD average of 0.3% would be enough to allow the trilateral partners to compete with China as an infrastructure financier at its current scale (or avoid being left behind if China increases its financing further). Importantly, this would allow the trilateral partners to compete with China in infrastructure in Southeast Asia without sacrificing other development priorities – such as in health, education, and developing other parts of the world – which remain no less important than before.

Political appetite among the trilateral partners for increasing overseas development spending in the immediate aftermath of the COVID-19 pandemic may however be limited. The political priority will

likely be on meeting domestic spending needs while the politics of increased public debt may serve as a major constraint (even if government borrowing costs are expected to remain extremely low for some time). A realistic ambition might thus be about preserving current spending levels or perhaps achieving only modest increases. Linking increased development financing to the new geostrategic paradigm and a coordinated approach among the partners could assist in securing domestic support for this agenda. Additional scale could also be achieved if increased funding were at least partly channelled towards introducing more concessionality into current blended-financing efforts. This would help make more potential projects financially viable – especially critical for less developed countries and poorer areas within countries where the investment needs are greatest, but financial viability are most limited.

#### **5. Australia should consider further steps to enhance its own development financing capabilities to match those of Japan and the United States.**

Australia is the only trilateral partner that lacks a dedicated international development agency, after integrating its bilateral aid agency into the Department of Foreign Affairs and Trade six years ago. Australia is also the only trilateral partner without an ability to directly provide concessional loans (outside of the Pacific) or more innovative blended-financing instruments such as development guarantees and equity investments. While Export Finance Australia can deploy a variety of financing instruments, its focus is on commercial financing and maximizing the benefits to Australia, rather than concessional financing and sustainable development. The simplest approach would be to build on the new Pacific infrastructure financing facility to allow for concessional loans in other regions and a wider range of development financing instruments.<sup>29</sup> A more ambitious option would be to establish a dedicated Australian development finance institution, as the United States, Japan, and other developed country governments have done.

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- 16 Samantha Attridge and Lars Engen, “Blended finance in the poorest countries: the need for a better approach,” (London: Overseas Development Institute, April 2019), <https://www.odi.org/publications/11303-blended-finance-poorest-countries-need-better-approach>; Charles Kenny, “Marginal, Not Transformational: Development Finance Institutions and the Sustainable Development Goals,” (Washington, DC: Center for Global Development, September 2019), <https://www.cgdev.org/sites/default/files/PP156-Kenny-Marginal-Not-Transformational.pdf>.
- 17 Judith E. Tyson, “Private infrastructure financing in developing countries,” (London: Overseas Development Institute, August 2018), <https://www.odi.org/sites/odi.org.uk/files/resource-documents/12366.pdf>.
- 18 “Contribution of Institutional Investors Private Investment in Infrastructure 2011–H1 2017,” (Washington DC: World Bank, 2018), [https://ppi.worldbank.org/content/dam/PPI/documents/PPI\\_InstitutionalInvestors\\_Update\\_2017.pdf](https://ppi.worldbank.org/content/dam/PPI/documents/PPI_InstitutionalInvestors_Update_2017.pdf).
- 19 Ibid.
- 20 Leveraged private capital is calculated as total investment minus identified official financing support from multilateral, bilateral, and domestic government sources. Given the definition of PPI used by the World Bank, this does not strictly exclude non-private sources of finance. However, the data indicates the majority of investment has been private (noting that the PPI data treats foreign state-owned enterprises as private).
- 21 Kenny, “Marginal, Not Transformational.” Kenny estimates a global leverage ratio of 1.8 using PPI data.
- 22 For cofinanced projects, the leverage ratio is the ratio between total official financing (both bilateral and multilateral) and private financing.
- 23 “World Bank Group Support to Public-Private Partnerships,” (Washington DC: Independent Evaluation Group, 2013), <https://ieg.worldbankgroup.org/evaluations/world-bank-group-support-ppp>; “The International Finance Corporation’s Approach to Engaging Clients for Increased Development Impact,” (Washington DC: Independent Evaluation Group, 2017), <https://ieg.worldbankgroup.org/evaluations/ifc-client-engagement>.

24 David Bray, et al., “Assessment of the Effectiveness of Project Preparation Facilities in Asia,” (Toronto: G20 Development Working Group, September 2014), <http://g20.org.tr/wp-content/uploads/2014/12/assessment-effectiveness-ppfs-in-asia-15092014.pdf>.

25 Fitch Solutions has compiled alternative figures to those presented in this policy brief that suggest that Japanese infrastructure financing in Southeast Asia is larger than that from China, with \$367 billion in Japanese infrastructure projects in Southeast Asia under preparation or construction, compared to \$255 billion for China. However, the basis of these figures is unclear and, given the scale estimated, would appear to go well beyond projects supported by official finance. It may, for instance, include purely commercial investments involving no official financing as well as projects where Japanese or Chinese firms are involved only as construction or engineering contractors. Even then, the figures seem large, considering ADB estimates that total annual infrastructure investment in Southeast Asia from all sources was only \$55 billion in 2015. “China No Match for Japan in Southeast Asia Infrastructure Race,” Bloomberg, June 23, 2019, <https://www.bloomberg.com/news/articles/2019-06-23/china-no-match-for-japan-in-southeast-asia-infrastructure-race>.

26 Official development assistance is by definition concessional in nature. However, other official finance is also often provided on terms considerably better than that available from the market.

27 For instance, see comments by Malaysian Prime Minister Mahathir Mohamad, despite the issues experienced with the ECRL project: Marian Zhou, “Mahathir: ‘We have to go to the Chinese’ for infrastructure,” Nikkei Asian Review, September 27, 2019, <https://asia.nikkei.com/Politics/International-relations/Mahathir-We-have-to-go-to-the-Chinese-for-infrastructure2>.

28 “Net ODA,” Organisation for Economic Cooperation and Development, <https://data.oecd.org/oda/net-oda.htm>.

29 An independent study was commissioned to recommend potential options, but the status of the report has remained unclear for over a year. See Stephen Howes, “Possible downsides to a new international development policy,” DevPolicy Blog, February 4, 2020, <https://devpolicy.org/possible-downsides-to-new-international-development-policy-20200204/>.

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