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Can and should the US compete with China in global infrastructure financing?

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Introduction

Neglected for decades by developed countries and international development institutions, infrastructure has garnered renewed attention. With the global infrastructure gap estimated to exceed US$40 trillion, the need for more infrastructure is overwhelming.

China's Belt and Road Initiative (BRI), inescapable due to its size and ambition, is also renewing attention on infrastructure projects. China's promise to spend trillions of dollars in infrastructure through the initiative, ostensibly to strengthen global trade routes, has raised much concern in many countries and triggered the ideation of equally ambitious plans for infrastructure development.

Chief among the competitors is the United States. At the 2021 G7 Summit, the US launched the Build Back Better World initiative, or B3W. Established to build infrastructure, B3W is also expected to set new standards that better reflect the values of Western democracies, and balance against the BRI and China's global reach. The questions many are asking: Will the initiative be successful? Can or should the US compete with China in infrastructure diplomacy? Can the B3W and the BRI collaborate?

This paper compares China's BRI and the US-led B3W, focusing on the differences between the two approaches and the limitations of B3W to compete with the BRI. Rather than concentrating their resources into a difficult mission of competing with China's infrastructure investments, the paper argues for the US to cooperate with Beijing where it can, continue to promote better international standards, and contend in sectors where it enjoys competitive advantages, such as in services, education, finance, health, and science.

A persistent gap

Infrastructure is essential for economic development and promoting the global circulation of people and goods. There is an enormous need for more infrastructure. Studies estimate that developing countries require more than US$40 trillion in the next two decades to bridge their infrastructure gaps and help them prosper, especially after the COVID-19 pandemic.[1] According to the Asian Development Bank, developing countries in the Asia Pacific region alone face an infrastructure gap of US$22.6 trillion through 2030.[2] The sectors most in need of investments are energy, transportation, telecommunication, water, and sanitation. Much more is needed by the rest of the developing world.

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However, infrastructure development is challenging. Returns are not instant. Many private investors have been discouraged by the major political, social, and environmental risks associated with constructing infrastructure in the developing world. As a result, Western economies have reduced their infrastructure investments in developing countries, particularly since the 1990s. By the turn of the century, the share of US direct investment in developing economies had fallen considerably, from 37% in 1996 to 21%, as US investors turned to to high-income economies.[3] In the early days of the World Bank Group, 70% of its financing was channeled toward economic infrastructure. The ratio has since dropped to 30%.[4]

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Figure 1 – China's Belt and Road Initiative

Historically, infrastructure is an important source of power in international politics. With projects all over the world, the Belt and Road Initiative has magnified concerns about the international soft power and political leverage that China has acquired.

Enter China in this contest of paucity in infrastructure investment. Through official development financing and the BRI, China has been gaining a competitive advantage and filling the gap in global infrastructure construction. Launched in 2013, the BRI extends to Asia, Europe, Africa, and even Latin America, and aims to reconnect Eurasia with the world through a network of infrastructure and trillions of dollars in investments. Largely supporting connectivity – be they railways, highways, ports, energy, and telecommunications – the investments are bringing countries closer together and increasing trade volumes.

With thousands of projects underway, the BRI's economic impact is already evident.[5] Trade in goods between China and BRI countries has increased. Between 2013 and 2018, China's trade in goods with other BRI countries surpassed US$5 trillion. Foreign direct investments (FDI) exceeded US$70 billion.[6] The BRI brought infrastructure back to the center of international debate and highlighted the persistent gap between developed and developing countries,

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In response, many countries have scrambled to create their own master plans for connectivity, development, and infrastructure. The list of initiatives is extensive. For example, South Korea's Eurasia Initiative hopes to strengthen and expand the trans-regional corridor of transportation, logistics, and energy between the two Koreas. The project, launched in 2013, also seeks to promote the development of the "creative economy."[7]

Japan's Quality Infrastructure project, launched in 2015 by former Prime Minister Shinto Abe, promotes "quality infrastructure investments" through collaboration with other countries and international organizations.[8] Meanwhile, Turkey's Middle Corridor project – also known as the Trans-Caspian East-West-Middle Corridor Initiative – connects the Caucasus and Central Asia through roads and rails before reaching China. Launched in 2015, it was considered "one of the most important components of the efforts to revive the ancient Silk Road".[9]

In 2018, the Euro-Asian Connectivity Strategy was launched by the EU, with the adoption of joint communication on 'Connecting Europe and Asia – Building blocks for an EU strategy'. According to the strategy, the EU would exploit existing networks and engage with its Asian partners through "a sustainable, comprehensive and rules-based approach to connectivity".[10]

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The US did not sit idle. In 2019, the Trump administration tried to use the Blue Dot Network to counter China. When the Biden Administration launched B3W, its goal became apparent. It seeks to mobilize infrastructure investments in low and middle-income countries to counteract the BRI and align other countries within a liberal sphere of influence.

Capitalizing on strengths and needs

China has championed domestic infrastructure development at a scale never seen before. As European nations began to withdraw from investing in infrastructure in the developing world in the 1990s, Beijing has tried – mostly successfully – to fill the gap.[11] China's economic rise, which started in the 1980s, was supported by one of the highest rates of infrastructure investment as a percentage of GDP.[12] These efforts have persisted apace today.[13]

To support these efforts, China has created a comprehensive ecosystem. The establishment of technical universities has led to a cadre of new engineers that were promptly used in service of the country's economic and infrastructure boom. The subsequent surplus in infrastructure capacity was gradually integrated by Beijing into a foreign policy regime in search for new markets and soft power. With the BRI capitalizing on the country's strengths and needs, China was able to channel its surplus capital, infrastructure know-how, and overcapacity, which faced diminishing returns at home.[14]

China was also able to utilize its considerable institutional capacity, including its ability to collectively mobilize development financing, insurance, and building of infrastructure. From 2013 to 2020, China invested more than US$731 billion worldwide, with particular focus on the energy and transport sectors.[15] The investments enabled China to profit from new markets, diversify from over-reliance on the domestic market and Treasury Bills, and expand its soft power.[16]

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The BRI would not have been possible without strong government support. Investments and financing are essential to realizing connectivity, infrastructure, and facilitating unimpeded trade. Currently, the BRI's main funding source are sovereign loans provided by China. From 2013 to 2017, China Development Bank (CDB) cumulatively extended US$170 billion to some 64 BRI countries, and China's Export Import Bank (Exim Bank) signed more than 1,200 contracts worth some 800 billion RMB.[17] The Bank of China invested more than US$460 billion.[18]

From the establishment of technical universities to lending hundreds of billions through state banks, China has created a comprehensive ecosystem to support its investment in infrastructure in the developing world.

To increase this pool of funds, Chinese enterprises have increasingly considered new business models, such as public-private-partnerships (PPP) and build-operate-transfer contracts.[19]

In contrast, multilateral development banks have invested much less. Two World Bank Group institutions extended a total of US$45.9 billion for infrastructure investments, while the ADB provided US$17.47 in financing.

The BRI has also benefited from the relative ease in operationalizing support. Beijing offers a one-stop shop for finance, insurance, and building for host countries. The processes are also often cheaper and faster than negotiations with Western financiers. Consider the case of Africa, where China – the largest single financier for infrastructure – funds 20% of all infrastructure projects. Furthermore, one-third of all infrastructure projects are built by Chinese firms.[20] According to a McKinsey & Company report, more than 10,000 Chinese-owned firms were operating in Africa in 2017.[21]

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Indeed, many low- and middle-income countries on the continent look to Beijing as the financier of first resort, preferring China's state-backed loans over higher-cost and shorter-term private funding.[22] In their view, Western financiers tend to apply more stringent rules and conditionalities that often slow down the realization of a project and make it more expensive.[23] Financing recipients also appreciate that the know-how acquired by China can be easily transmitted through strong government action. Chinese ministers are aligned, and policies are coordinated under the central government's purview.

Important government departments that support the BRI, for example, include the National Development and Reform Commission, the Ministry of Finance, the Ministry of Foreign Affairs, the Ministry of Commerce, and the People's Bank of China. Chinese financial institutions are also aligned and at the forefront of the initiative, particularly Exim Bank, the CDB, and China Export & Credit Insurance

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Corporation (Sinosure). Led by clear state policy, these institutions operate in tandem and remain tied to construction companies that China finances and insures.

In addition, China has created the Silk Road Fund and leads the Asia Infrastructure Investment Bank, although these initiatives do not and cannot fund most of the projects.[24]

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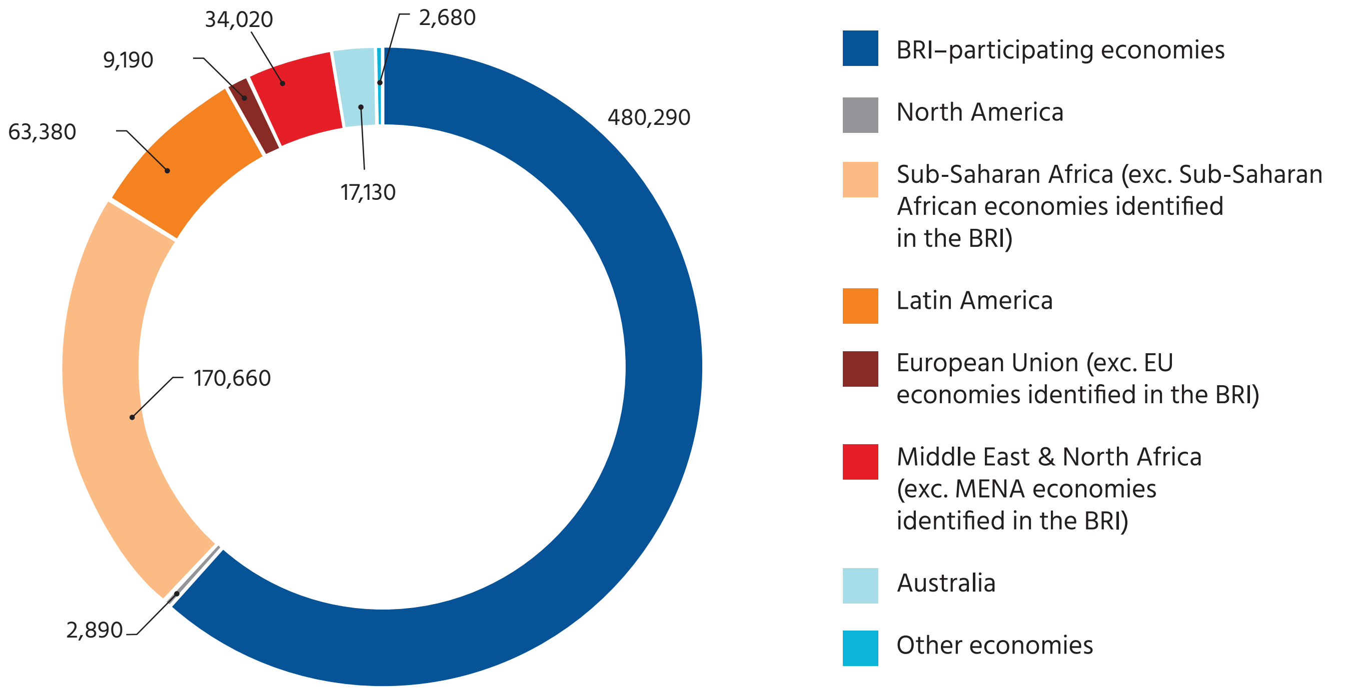
Over time, this choice has become fraught with risks. Besides the manifold political risks in developing countries, the BRI's reputation has been challenged by the lack of transparency of the loans and economic sustainability of some projects, the unsustainability of the debt, and overdependence on Chinese financing that can become a source of Beijing's influence. Even before the Covid-19 pandemic, the inability of some countries to repay their debt to China led to various debt renegotiations, which resulted mostly in an extension of the repayment terms rather than debt forgiveness or asset seizure.[26]

This predicament was predictable. In the early years of its "Going Out" policy, China often adopted a "build and they will come" approach, while foregoing appropriate studies about the risks and economic returns of the investments. Today, with many projects continuing to incur heavy environmental and social impact, Beijing is making serious efforts to create rules and guidelines to limit such damages.

In 2019, China – cognizant of the substantive environmental impact of some BRI projects as well as its own ambition to be a global leader in 'green growth' – launched the BRI International Green Development Coalition.[27] The alliance of 134 partners, including 26 Environmental Ministries of UN Member States, aims to make BRI investments sustainable and adherent to the United Nations' 2030

Figure 2 – Chinese outward investment in the construction sector, cumulative notional amount expressed in US$ million, 2005-2018



Note: 2018 data are to end-June.
Source: American Enterprise Institute (AEI), China Global Investment Tracker Database, via OECD (2018), https://www.oecd.org/finance/Chinas-Belt-and-Road-Initiative-in-the-global-trade-investment-and-finance-landscape.pdf. It includes all investments of US$100 million or greater.

Agenda for Sustainable Development. It is difficult to provide a final verdict about the progress of such cooperation, but studies show the two agendas having many synergies.[28]

A coalition to 'build back better'

Current US foreign policy is largely dictated by the goal of rebalancing and containing China's rise. The contest has extended into virtually every field. For the US, China represents an existential threat to its hegemony and system of values.

The US also hopes to promote an upward competition of standards that would force Chinese companies to accept Western rule of law and governance standards, thereby extending US influence in the Indo-Pacific.

Washington is increasingly concerned that China will expand its economic and political influence through its infrastructure investments and diplomacy. In response, the US has created its own infrastructure strategy that includes the Blue Dot Network and the B3W. The goal is to create a competitive advantage for the United States in global infrastructure financing, through the establishment of "high standards" that reflect American values and interests.[29] Combined with a limited use of public funds, the high-standard certification process would help leverage a wide range of private capital – especially pensions and insurance funds – to invest in infrastructure and obtain long-term returns.[30] The US also hopes to promote an upward competition of standards that would force Chinese companies to accept Western rule of law and governance standards, thereby extending US influence in the Indo-Pacific.

US President Joe Biden announced the 'Build Back Better for the World' (B3W) proposal during this year's G7 summit in Glasgow. The aim is clear: to counter Beijing's growing influence through the BRI.

The initiative began with the administration of former US President Donald Trump. In accordance with the Better Utilization of Investments Leading to Development Act of 2018 (BUILD Act), the Trump administration integrated and upgraded the US Overseas Private Investment Corporation (OPIC) before merging it with the Development Credit Authority under the United States Agency for International Development. The agency that emerged from the restructuring is the International Development Finance Corporation (DFC). Shortly after commencing operations in 2019, the DFC doubled the investment limits of its predecessor and reached a spending cap of US$60 billion.[31]

Another Trump Administration initiative – the Blue Dot network – was established to promote private sector and civil society participation in setting infrastructure construction standards that reflect principles of good governance, environmental management, and transparency. According to the approach, stronger standards help to attract private capital to infrastructure investments in developing countries and create global certifications for infrastructure' financing and construction that are fit for purpose. The network launched on the sidelines of the 35th ASEAN Summit with a coalition comprised of the DFC, the Japan Bank for International Cooperation, and the Australian Department for Foreign Affairs and Trade.

The two initiatives share a similar focus: to promote good governance and high standards, such as transparency and financial, environmental, and social sustainability.[32] The commitment to climate resilience is also reflected in the stipulation for investments to align with the objectives set by the Paris Agreement. The B3W continues to focus on mobilizing private investment, by increasing the number of financial instruments available to catalyze new investments.

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The initiatives face significant limitations. The Blue Dot Network has limited public funds and insufficient capacity to mobilize private capital to invest in infrastructure. It faces difficulty in formulating high-quality certification standards that are feasible and operable. Lastly, due to a shortage of manpower and

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limited funds, it is unable to identify who will ultimately supervise the quality of investments. Federal budget scoring rules also prevent the DFC from fully realizing its ability to make equity investments in developing markets.[33]

The agencies' collective envelope is also smaller. The DFC's allotment of US$60 billion under the BUILD Act pales in comparison to the capacity of China's state-run policy banks. China Development Bank is the world's largest provider of development finance and has committed US$250 billion to the BRI.[34] As of April 2019, China Exim Bank's outstanding loans for BRI-related projects had exceeded US$149 billion.[35]

The B3W also faces challenges in securing long-term sources of funding. Struggling with the costs of the pandemic, developed countries are invariably not willing to take on risky projects with low returns. Even if they find investors willing to invest in risky projects, it is doubtful that G7 nations will guarantee lending conditions as competitive as those of China. The G7 countries also have different positions toward China, as well as limited overall fiscal and institutional capacity for large-scale infrastructure investments. Even public funding may be difficult to procure. After all, at over 130% of GDP, the US national debt has reached its highest level in history and is expected to worsen in coming decades.[36]

Given its high environmental and governance standards, the investments will incur even higher costs for the developing countries.

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Lastly, the US has not integrated infrastructure development into its foreign policy since the Marshall Plan, for which it exported capital to rebuild Europe, and instead has channeled investments through the Bretton Woods Institutions. Its own infrastructure record at home is poor. The US maintains low levels of infrastructure investment that has not exceeded 1% of GDP since the 1950s, when different administrations started to focus on shorter-term visions.[37] Just to maintain its crumbling infrastructure, the US would require US$2.59 trillion, a problem exacerbated by the political gridlock in Washington.[38] It takes a lot of imagination for the US to suddenly become a global leader in infrastructure construction.

Can the US compete with China?

Despite the new declarative efforts and much fanfare of both the Trump and Biden administration to launch alternatives to the BRI, the US offer remains preliminary. The challenges facing the US are multi-fold, including a lack of funding and long-term vision, insufficient state support, and deteriorating infrastructure at home that dispel arguments about American competitiveness.

It is challenging to convince private companies in G7 countries to invest in the developing world; there are not enough incentives for private investors who see high risks for low long-term returns.

As mentioned, the differences in funding are significant. The BRI is funded in large part by Chinese public banks and offers a one-stop-shop package that includes project financing, insurance, and construction. In contrast, the B3W seeks to leverage private funding and offers less convenience. It is challenging to convince private companies in G7 countries to invest in the developing world; there are simply not enough incentives for private investors who see high risks for low long-term returns. In many projects, the economic returns are often much less than the political returns, especially in unstable situations with unfavorable investment environments.

Currently, bank loans are the largest source of infrastructure funding. Equity investment remains inadequate, including those created by China (ie. the Silk Road Fund and the China-Africa Development Fund). Only 0.2% of infrastructure investment in Asian countries come from the private sector.[39] A path forward might lie in PPPs, but the private sector cannot do it alone.

For host countries, the US led initiatives are not necessarily advantageous or even possible. Given the high standards imposed by the B3W or the Blue Dot Network and the expected profits of the investors, the time and costs for infrastructure projects would levitate.

Applying investment rules of high standards to BRI countries may be unworkable, as many lack the proper resources and governance to follow these regulations.

As its overseas interests and investments grow, China's stance on sovereignty may change and its influence in the internal affairs of other countries may be more apparent.

China is trying to develop higher standards and a more transparent approach for its infrastructure investments abroad. To date, Beijing shows little interest in promoting a top-down approach that excessively influences the legal and political structure of host countries.[40] For the most part, China has seemed pragmatic and tended to abide by its principle of non-interference in other countries' affairs. However, as its overseas interests and investments grow, China's stance on sovereignty may change and its influence in the internal affairs of other countries may be more apparent.[41] New research shows how the terms of Chinese loans, while not necessarily enforceable in court, could limit the crisis management options of the sovereign debtor and make difficult debt renegotiations more difficult.[42]

In terms of constraints, China has not copied and cannot copy high standards related to investments and financing. Applying these rules to BRI countries may be unworkable. The regulations are difficult to apply to countries with poor governance and scarce legal and human resources. Despite the moral and ethical difficulty to even think about possible trade-offs concerning health and safety, high labor standards that guarantee safe and healthy workplaces – as is typically the norm in developed Western countries – may be difficult to achieve in some host countries.[43] Moreover, these rules require higher costs that are not affordable to many host countries with limited resources. For instance, when countries receive money from the International Monetary Fund or the Paris Club, they must carry out expensive policy adjustment plans but often lack the requisite resources.

In terms of infrastructure diplomacy, the US also lags behind China and lacks the necessary institutional mechanisms to be fairly compared with the BRI. The DFC simply cannot compete with the infrastructure diplomacy machinery that can bring together and direct policies and guidelines for finance, insurance, and construction companies. The task is not impossible. But it will take time, failures, and bear uncertain results.

There may be better ways for the US to reassert its soft power. For example, the US can consider its own nature of being an importer of capital, and its advantages in the services sector, education, health, and fostering educational and diplomatic ties.

The US can and should focus on actionable goals and comparative advantages, through which it can leverage its soft power in the developing world.

Are there alternatives to the BRI?

China's competitive advantage in infrastructure diplomacy is not in failing to comply with international rules and cutting social, labor, or environmental costs. Rather, it rests primarily in the package it offers: a consolidated government and institutional machinery that offers finance, insurance, and building infrastructure.

China is a challenge and a competitor for the US – that is clear. However, the US can and should focus on actionable goals and comparative advantages, through which it can leverage its soft power in the developing world. It is possible for the US to reinvest in infrastructure and leverage it in its foreign policy. But will it be worth the effort?

There may be better ways for the US to reassert its soft power. There may also be better ways to leverage Chinese construction of basic infrastructure around the developing world. For example, the US can consider its own nature of being an importer of capital, and its advantages in the services sector, education, health, and fostering educational and diplomatic ties.

By cooperating and competing where needed, China and the United States may be able to ameliorate their development models and contribute to global infrastructure construction and sustainable development.

To China, the US also represents an essential partner for dealing with global challenges. It is prudent to identify areas where the US cannot cooperate for national security reasons. It is also prudent to explore room for cooperation between China, the US, and other Western countries. Given the differences of the two models, the US should try to find synergies, if an open and inclusive system of rules is followed. By cooperating and competing where needed, China and the United States may be able to ameliorate their development models and contribute to global infrastructure construction and sustainable development.

From a financial standpoint, such cooperation has already taken place. We can see instances in which the CDB and Exim bank discussed cooperation with the European Bank for Reconstruction and Development. Similar efforts have taken place between the CDB and the French Development Agency. Another example is the China-CEE Countries Inter-bank Association – which includes former Eastern bloc countries – that was established in 2017.

The need is urgent for the US and China to better coordinate international infrastructure investments, effectively allocate resources, and avoid duplicates or overlapping of initiatives. Most importantly, they must consider the real needs of the developing world rather than simply fall prey to geopolitics and strategic considerations. Many recipient countries are not willing to fall into the new Cold War divide. Instead, they are pining for roads and basic infrastructure that support economic development and growth – and partners for the journey.

About the author

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Notes

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14. Various explanations have been offered for China's large current-account surplus. For

some Chinese national savings and saving behaviors is a t the root of the surplus of capital, for others is the demographic transition and the implementation of the one-child policy, or for some capital inflows disguised as a current-account surplus. For a discussion of the reasons see: https://voxeu.org/article/what-caused-china-s-current-account-surplus; Yiping Huang, Kunyu Tao, "Factor market distortion and the current account surplus in China," Asian Economic, Pape 9:3, 2010.
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