
ASEAN Connectivity and China–Japan Infrastructure Export Competition

Challenges facing ASEAN Integration

Blake H. Berger

INTRODUCTION

ASEAN's regional integration initiative can be traced back to the initiation of the ASEAN Free Trade Agreement (AFTA) in 1992. China and Japan have been steadfast partners of ASEAN in its pursuit of its regional integration goal. Integration in Southeast Asia gained further steam when the organisation adopted the ASEAN Economic Community (AEC) in 2007 and the Master Plan for ASEAN Connectivity (MPAC) in 2010. China and Japan are poised through their respective economic plans and infrastructure exports to significantly assist the region in bolstering its integration initiative, whether through the construction of high-speed rail (HSR) links or port development. Both China and Japan have increased not only their diplomatic outreach and institution building with ASEAN and its member states but have also substantially strengthened their economic and infrastructure engagement with the region, under the Belt and Road Initiative (BRI) and Partnership for Quality Infrastructure (PQI), respectively. While the two states' infrastructure exports help support ASEAN's connectivity goals, their rivalry may hamper cohesive integration in ASEAN.

This paper is structured as follows. The first section provides a brief overview of the concepts of regional integration and connectivity in general, and the rationale and specific plans behind the AEC and MPAC. The second section explores China and Japan's calculations in initiating the BRI and PQI, respectively, and their engagement with ASEAN and its members. The third section highlights some of the challenges surrounding ASEAN integration and provides policy recommendations.

ASEAN, REGIONAL INTEGRATION, AND CONNECTIVITY

While regional integration and connectivity have become synonymous buzzwords utilised in describing the processes undergirding the AEC and

MPAC, the terms, in fact, connote differing processes. Regional integration can be conceived conceptually as two distinct processes. First, regional integration as both an informal and formal process through which geographically proximate states attempt policy coordination and the corollary implementation of common policies.⁷⁷ Second, integration conceived as both a re-regulatory and deregulatory process, where states adopt new common policies and dually remove certain barriers to trade and investment, respectively.⁷⁸ The process of connectivity, on the other hand, is considered the foundational building blocks of the convergence and cohesion of a regional integration initiative through the development of linkages in transportation, energy infrastructure, and information and communication technology (ICT), which facilitate trade and investment and the reduction of associated costs.⁷⁹ In the case of ASEAN, the MPAC initiative comprises the necessary building blocks of hard and soft infrastructure to implement the AEC.

Understanding the political and economic calculations behind China and Japan's use of infrastructure exports in support of ASEAN integration requires an overview of ASEAN's rationale for advocating and advancing regional integration. Following ASEAN's attempts in the 1970s and 1980s to implement various economic cooperation initiatives, there was general recognition that these early attempts were ineffective. In the 1990s, following the establishment of the North America Free Trade Area (NAFTA) and the Asia-Pacific Economic Cooperation (APEC) process, the signing of the 1991 European Union Maastricht Accord, and the opening up of China through its economic reform programme, ASEAN leaders became concerned that foreign direct investment (FDI) might be diverted from Southeast Asia to other regions and China. Such diversion would have in turn negatively affected regional economic growth.⁸⁰

77 Douglas Webber and Bertrand Fort, *Regional Integration in East Asia and Europe: Convergence or Divergence?* (London and New York: Routledge, 2006).

78 Simon Hix, "Institutional Design of Regional Integration: Balancing Delegation and Representation," Asian Development Bank Working Paper Series on Regional Economic Integration, No. 64, ADB 2010.

79 Prabir De, "India's Emerging Connectivity with Southeast Asia: Progress and Prospects." ADBI Working Paper 507. Asian Development Bank Institute, 2014.

80 Hal Hill and Jayant Menon, "ASEAN Commercial Policy: A Rare Case of Outward-Looking Regional Integration." Asian Development Bank Working Paper Series on Regional Economic Integration, No. 144. Asian Development Bank, November 2014.

To adequately address this economic challenge, ASEAN throughout the 1990s, especially following the Asian Financial Crisis of 1997–1998, sought to bolster its institutions and coordination. As a result, the ASEAN leaders adopted the AEC in 2007, which is founded upon four key pillars; first, a single market and production base; second, a highly competitive economic region; third, equitable economic development in ASEAN; and fourth, a region that is fully integrated into the global economy.⁸¹

Despite ASEAN intentions to establish a single market and production base and a competitive region, its infrastructure deficit remains a significant impediment to the realisation of its goals. The gap in infrastructure availability and quality in the region is stark, ranging from Singapore’s world-class sea, airports and logistics infrastructure to the lack of adequate infrastructure to facilitate the movement of goods domestically in Cambodia, Laos, Vietnam, Myanmar, Indonesia, and the Philippines.⁸² The regional infrastructure deficit adversely affects economic competitiveness as inadequate infrastructure raises transportation and trade costs, acts as a barrier to cohesive and consolidated production networks, and impedes successful industrial and economic development.⁸³ In recognising these challenges and the need for infrastructure development, the ASEAN leaders in October 2007 adopted MPAC, which emphasised three dimensions of connectivity: first, physical; second, institutional; and third, people-to-people. Key MPAC projects include the ASEAN Highway Network (AHN), the Singapore-Kunming Rail Link (SKRL), the ASEAN Power Grid (APG), and the Trans-ASEAN Gas Pipelines (TAGP).

While the adoption of the MPAC signalled ASEAN’s commitment to improving infrastructure, financing these projects remains a daunting and substantial obstacle. The Asian Development Bank (ADB) estimates that between 2016 and 2030, ASEAN needs US\$217 billion annually to finance infrastructure. However, the current estimated annual funding gap

81 ASEAN Secretariat, “ASEAN Economic Community,” Jakarta 2008.

82 Chia Siow Yue, “ASEAN Economic Integration and Physical Connectivity,” *Asian Economic Papers* 15, Vol. 2 (2016).

83 Hong Yu, Hong, “Infrastructure Connectivity and Regional Economic Integration in East Asia: Progress and Challenges,” *Global-is-Asian Insight*, Lee Kuan Yew School of Public Policy, 2017.

is US\$139 billion.⁸⁴ In order to support the MPAC and to narrow the funding gap, ASEAN members and the ADB in 2011 signed and established the ASEAN Infrastructure Fund (AIF), which aims to provide US\$300 million a year in loans to finance infrastructure projects.⁸⁵ However, the AIF is unable to meet the needs of the region. This fact was underscored by Rahmat Pramo, Indonesia's Representative to the ASEAN Connectivity Coordinating Committee (ACCC): "ASEAN needs US\$600 billion for physical connectivity. We have the ASEAN infrastructure fund, but it is not sufficient to finance all the projects."⁸⁶ While ASEAN and the ADB have been unable to meet the financing needs of the region, China and Japan through their own initiatives have stepped up to support ASEAN's infrastructure financing and construction needs. As ASEAN members welcome both China and Japan's support, the Sino-Japanese rivalry may have negative economic and political implications for the region.

CHINA'S BRI, JAPAN'S PQI, AND THE RATIONALE BEHIND THE PLANS

Japan and China have been dialogue partners of ASEAN for 45 and 27 years, respectively, and have both played substantial roles in establishing and strengthening the region's production networks and supply chains. Although both countries are proactive in engaging the region economically and contribute to regional integration through infrastructure exports, the rivalry between them has the potential to constrain the development of a cohesive integrated region, further stress ASEAN unity, and strain diplomatic relations between ASEAN member states.

In October 2013, President Xi Jinping unveiled the 21st Century Maritime Silk Road Initiative during a trip to Indonesia. The Maritime Silk Road is one of the major routes of China's BRI, stretching from Southeast Asia to Africa, while the other section, the Silk Road Economic Belt, starts in China and ends in Europe. In order to finance, and provide technical support for,

84 Asian Development Bank, "Meeting Asia's Infrastructure Needs," (Manila: Asian Development Bank, 2017): xvi.

85 Asian Development Bank, "ASEAN Infrastructure Fund (AIF)," 2017, <https://www.adb.org/site/funds/funds/asean-infrastructure-fund>

86 "ASEAN Connectivity: A Role for Europe?" *Friends of Europe*, Spring 2014.

BRI projects, China established the Asian Infrastructure Investment Bank (AIIB) in 2014. The rationales behind the BRI and the AIIB are both rooted in economic and political justifications.

Economically, there are three primary overlapping purposes. First, by modernising partner country transportation and infrastructure facilities, China can not only increase bilateral trade but also secure reliable trading routes. Second, as China shifts from an economy founded upon manufacturing-oriented growth to a more balanced model that emphasises growing domestic consumption, it needs to export its excess production capacity to neighbouring states, and additionally, through infrastructure exports, support the global expansion of Chinese companies. Third, through the creation of the BRI, China seeks to integrate its inland western provinces, such as Guangxi, Yunnan, and Xinjiang, into global supply chains and production networks, and, thereby improve their economic development.

Politically, the BRI and AIIB can be seen as serving several purposes. First, through infrastructure exports and financing, China seeks to strengthen its geopolitical influence over recipient states. Second, the establishment of the AIIB can be seen as the result of China's frustration that it was not getting international respect commensurate with its economic growth, notably that reforms within international financial institutions, such as the International Monetary Fund (IMF) and World Bank, have been slow.⁸⁷

Supplementing the BRI and AIIB, China has two additional financing mechanisms to support the AEC, and MPAC. The first is the China-ASEAN Investment Cooperation Fund (CAF), jointly established by China and ASEAN in 2009. CAF is a quasi-sovereign equity fund backed by the Export-Import Bank of China (EXIM Bank of China) and focuses on the infrastructure, energy, and natural resource sectors. On 23 January 2018, CAF announced that it was seeking to raise US\$3 billion, with US\$1 billion specifically coming from Chinese state-owned enterprises (SOEs). CAF has

87 Hong Yu, "Motivation Behind China's 'One Belt, One Road' Initiatives and Establishment of the Asian Infrastructure Investment Bank." *Journal of Contemporary China*, 26 (2017):105, 353–368.

already invested in infrastructure projects in Thailand and the Philippines.⁸⁸ The second mechanism is the US\$40 billion Silk Road Fund, which China established in December 2014 as an additional means to finance infrastructure, resources, and financial cooperation projects. Under the BRI umbrella and infrastructure exports, China has made significant inroads in ASEAN. China has not only strengthened its trade and production networks and advanced compatibility between the BRI and MPAC, but has also strengthened and extended its diplomatic influence throughout the region.

Despite Japan's longer dialogue relationship with ASEAN and history of infrastructure exports to the region, its contemporary ASEAN economic and infrastructure policy has been to a large extent developed in reaction to China's aggressive push for influence in the region. In direct response to China's BRI announcement in 2013, Prime Minister Shinzo Abe unveiled the PQI in 2015. During his announcement, Abe pledged US\$110 billion to finance quality infrastructure over the next five years, which was US\$10 billion more than the AIIB's initial capital.⁸⁹ The PQI is based upon "four concrete measures to pursue quality infrastructure: the full mobilization of Japan's economic cooperation tools; collaboration between Japan and the ADB; the doubling of funds for projects with relatively high risk profiles; and the promotion of quality infrastructure investment as an international standard. A crucial feature in the initiative was the combination of bilateral support through the Japan International Cooperation Agency (JICA) and the Japan Bank for International Cooperation (JBIC) with multilateral commitments represented by the ADB as a strategy to complement each other for offering high-quality infrastructure."⁹⁰ Both China and Japan utilise government institutions and intervention, albeit differently, to support their respective initiatives, i.e., the BRI and PQI.

Similar to China, the rationale behind Japan's PQI is both economic and geopolitical in nature. Economically, due to its rapidly aging and declining population, with the corollary reduction of sources of domestic investment

88 Julie Zhu, "ASEAN-focused China fund raising up to USD3 billion for Silk Road projects: sources," *Reuters*, January 23, 2018, <https://www.reuters.com/article/us-china-private-equity/asean-focused-china-fund-raising-up-to-3-billion-for-silk-road-projects-sources-idUSKBN1FC0SE>

89 Hidetaka Yoshimatsu, "Japan's Export of Infrastructure Systems: Pursuing Twin Goals through Developmental Means." *The Pacific Review*, 30 (2017): 4, 494–512.

90 Ibid: 496.

and consumption, Japan can no longer rely on the domestic market for future economic growth. Additionally, the appreciation of the yen over the years has prompted Japanese industries to speed up the relocation of their manufacturing and research and development (R&D) facilities overseas, resulting in the need to increase the procurement of parts and components from overseas markets. This led to a decline in Japan's export competitiveness. In order to secure future economic growth and strengthen the presence and profitability of Japanese businesses, Japan must further integrate itself into the global market. Politically, Japan has utilised the PQI to attain political and security objectives in ASEAN, particularly in aligning select ASEAN states' maritime policy with Tokyo's, strengthen its position in the region, and counter China's growing influence.⁹¹ Despite the increased attention surrounding the BRI, Japan's infrastructure investment in ASEAN is substantially larger than China's. Since 2000, Japan has invested roughly US\$230 billion in infrastructure, in comparison to China's US\$155 billion.⁹²

The Sino-Japanese rivalry is very much alive in ASEAN as the two states continue to compete over infrastructure development and geopolitical influence. This dynamic can be seen in the competition over railway infrastructure in Thailand, with China developing the Bangkok to Nakhon Ratchasima HSR line and Japan seeking to construct the Bangkok to Chang Mai line⁹³; the intense competition to bid for the construction of the Singapore–Kuala Lumpur HSR⁹⁴; the bidding competition over the Jakarta–Bandung HSR line, which China won and prompted Japan to bolster the PQI⁹⁵;

91 Ibid.

92 Siegrid Alegado, "Japan Still Beating China in Southeast Asia Infrastructure Race," *Bloomberg*, February 9, 2018, <https://www.bloomberg.com/news/articles/2018-02-08/japan-still-beating-china-in-southeast-asia-infrastructure-race>

93 Pavin Chachavalpongpun, "A Sino-Japanese Tug-of-War Taking Place in Thailand," *The Japan Times*, January 15, 2018, https://www.japantimes.co.jp/opinion/2018/01/15/commentary/japan-commentary/sino-japanese-tug-war-taking-place-thailand/#.WpZrC2aB0_V

94 "Japan Going All Out to Win KL-Singapore High-Speed Rail Contract." *Straits Times*, January 8, 2018, <http://www.straitstimes.com/asia/se-asia/japan-going-all-out-to-win-kl-spore-high-speed-rail-contract>

95 Robin Harding, Avantika Chilkoti, and Tom Mitchell, "Japan cries foul after Indonesia awards rail contract to China." *Financial Times*, October 1, 2015, <https://www.ft.com/content/eca4af84-67fa-11e5-97d0-1456a776a4f5>

and competing economic corridors and port development in Myanmar.⁹⁶ While Southeast Asia is poised to benefit from the Sino-Japanese competition over infrastructure via increased financing opportunities and sources, ample official development assistance (ODA), and funding for higher risk projects, the competition and rivalry may undermine ASEAN's ultimate goal of cohesively integrating the region.

CHALLENGES AND RECOMMENDATIONS

While ASEAN integration progresses, the region will undoubtedly benefit from the infrastructure exports from both China and Japan. However, the overlapping challenges facing the region are due to both institutional issues and the rivalry between the two powers. As the ASEAN Secretariat remains weak and underdeveloped, coordination across countries and sectors remains a significant obstacle; this problem is only accentuated by China and Japan's participation in developing competing infrastructure projects. This competition is especially salient when examining the SKRL, which stretches from Kunming through Vietnam, Laos, Cambodia, Thailand, Malaysia, and onto Singapore.

As China and Japan bilaterally negotiate with their ASEAN partners over the development of specific segments of the SKRL, significant concerns emerge over the compatibility and connectivity between the different lines, which would undoubtedly have an adverse effect on the efficiency of the project.⁹⁷ With China and Japan rapidly expanding their infrastructure exports and competing with one another to see who can offer the most favourable terms, this may result not only in economically non-viable projects but also poorly designed and inefficient infrastructure. "The availability of huge amounts of Chinese and Japanese capital can increase the risk of local malpractice and the possibility of high-ranking officials of the recipient countries engaging in bribery and corruption."⁹⁸

96 Wade Shepard, "China and Japan's 'New Great Game' Intensifies in Myanmar." *Forbes*, January 29, 2018. <https://www.forbes.com/sites/wadeshepard/2018/01/29/china-and-japans-new-great-game-intensifies-in-myanmar/#3e1e2b405ab2>

97 Hong Yu, "Infrastructure Connectivity and Regional Economic Integration in East Asia: Progress and Challenges."

98 Ibid: 22

Apart from adversely affecting infrastructure development in the region, the competition between China and Japan may further strain regional and bilateral ties. This was evident in the Jakarta-Bandung HSR bidding process, where Japan was caught off guard by Indonesia granting China the infrastructure contract. The resulting disappointment led Japan to adopt additional policies to counter the BRI.

To bolster implementation of MPAC and cohesive regional integration, ASEAN members should strengthen both the ASEAN Secretariat and the ASEAN Connectivity Coordinating Committee (ACCC), the committee in charge of ensuring implementation. In addition to strengthening the ACCC, ASEAN as an institution should play a larger role in the bidding process in order to ensure that the projects are economically viable, properly designed, and complementary to each other. This would not only ensure that the BRI and PQI are successful, but also that the MPAC initiative is not overtaken by the two rival initiatives.