

The EU-Japan connectivity partnership: a sustainable initiative awaiting materialisation

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Theme

Implementing the Partnership on Sustainable Connectivity and Quality Infrastructure promising agenda is yet to be done and would require a significant and sustained financial commitment, as well as an efficient coordination between the EU and Japan, and beyond.

Summary

Amid looming challenges derived from growing US unilateralism and Chinese assertiveness, the EU and Japan have repeatedly displayed their commitment to support an eroded rules-based multilateral order. Embodying ‘like-minded’ countries’ cooperation, both benefit from an Economic Partnership Agreement (EPA) and a Strategic Partnership Agreement (SPA) since early 2019. More recently, they have endorsed a Partnership on Sustainable Connectivity and Quality Infrastructure (hereafter the ‘EU-Japan Partnership on connectivity’ or ‘EU-Japan Partnership’) outlining a rather late but consolidated response to the global demand for connectivity, an acute understanding of its strategic implications and an alternative to the Chinese Belt and Road Initiative (BRI). Building on existing and convergent strategies, the EU-Japan Partnership on connectivity revolves around the guidelines of sustainability, high level of socio-economic and environmental standards and a level-playing field. Doing so, they address the current shortfalls of the BRI, including lack of transparency, the massive use of tied financing and uncertain financial and climate sustainability. It will be now a matter of implementation, requiring a significant financial engagement as well as an efficient coordination between the two partners, and beyond, with the private sector, other like-minded countries and, it is to be hoped, China. Achieving these conditions would be necessary to deliver the positive prospects of the EU-Japan Partnership and ensuring a significant contribution and leadership within the international order.

Analysis

Introduction: an ever-increasing cooperation in an uncertain era

At a time when international relations increasingly lean towards a more Hobbesian configuration, not least driven by a renewed scenario of global strategic competition between China and the US, cooperation between Japan and the EU has never seemed so crucial for backing multilateralism and an open and rules-based international order. With that prospect in mind, the two partners have already achieved a significant step in

the right direction with the entry into force of the EPA and SPA in February 2019. Building on the G20 Principles for Quality Infrastructure Investment approved at the G20 Osaka summit in late June 2019 and on Japan's promotion of Quality infrastructure and Digital free flow with trust, the EU and Japan further strengthened their cooperation with the announcement of their Partnership on Sustainable Connectivity and Quality Infrastructure on 27 September 2019. This arguably paves the way for a (more) sustainable model of infrastructure development, providing a welcome answer to a global demand for connectivity –a crucial pillar for economic growth and socioeconomic development–. Nevertheless, this praiseworthy initiative still appears a rather reactive feature and as an effort to catch up with China's BRI. Success, and a distinctive contribution, will now depend of the implementation of an added-value focus on sustainability, high socio-economic and environmental standards and a level-playing field.

Bridging the missing link: an anticipated contribution to the global connectivity challenge

Connectivity has re-emerged as a major driver, or at least a catchword in international relations and foreign policy, lying at the core of the massive-scale Chinese Belt and Road Initiative. Despite being a rather vague concept, it has been mainly framed as a pillar of trade and investment through improved infrastructure links, although it also extends to the digital realm and data flows, and encompasses policy coordination and people-to-people exchanges. A physical-infrastructure approach highlights its quantitative significance, with estimated financing needs amounting to US\$26 trillion by 2030 in Asia alone. This adds to increasingly salient strategic implications, which have framed US-Chinese competition for technological leadership, revolving, among other things, around digital connectivity and infrastructures including 5th Generation Communication networks (5G). The worldwide focus on connectivity has translated into a multitude of overlapping initiatives, including Japan's Free and Open Indo-Pacific (FIOP) and Partnerships for Quality Infrastructure, the Master Plan on ASEAN Connectivity 2025, EU's connectivity strategy, the Japan-India Asia-Africa Growth Corridor (AAGC) and, ultimately, the EU-Japan Partnership for connectivity.

The latter is another sign that the EU has finally endorsed a more active role in developing enhanced connectivity, especially with regards to Asia, as promoted during the Europa Connectivity Forum on 27 September 2019. EU-Asia connectivity is a priority for the new European Commission, echoing official statements from the former President of the Commission, Jean-Claude Juncker, and the EU Ambassador at large for connectivity, Romana Vlahutin. The EU's awareness of the multifaceted implications of connectivity has pushed it to develop and promote its own rules-based model of governance with a global reach.

As much as the EU-Japan Partnership is a welcome initiative, it still appears more reactive than proactive with regards to China and the BRI's deployment in the traditional EU and Japanese areas of influence and foreign-policy action, including South-East Asia and the Balkans. This has raised concerns that the BRI might provide a lever for influence to undermine certain values and standards. From a European perspective, this applies not only to EU candidate and neighbour countries, but also to some member states that benefited or would like to benefit from significant Chinese financial engagement. This

encompasses the take-over of the Greek port of Piraeus by the China Ocean Shipping Company (COSCO), the Belgrade-Bar highway from Serbia to Montenegro and the Belgrade-Budapest high speed railway.

Nevertheless, this new stage in EU-Japan cooperation is not a mere reaction, but rather a quality alternative to the current Chinese model of infrastructure development, although it is clearly not intended to be exclusive, nor framed against China. The UE and Japan are well aware of the global needs for infrastructure –US\$2.3 trillion per year in Eurasia– and China’s contribution to the latter, building on Chinese investments, expertise and technical assistance. Furthermore, a sustainable BRI could play the role of ‘accelerator’ and ‘effective vehicle’ for achieving the Sustainable Development Goals (SDG) and the 2030 Agenda, including SDG number 8 –to promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all– and 9 –to build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation–. Therefore, engaging China would be beneficial if it were to result in a better convergence of BRI standards with the principles advocated by the EU-Japan Partnership. This has been notably highlighted by the heads of the EU and Japan-led European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD) and Asian Development Bank (ADB) during the Europe-Asia Connectivity Forum. Multilateral cooperation would allow a win-win quality standard-raising agenda, addressing the current normative shortfalls of China’s development financing –eg, the lack of transparency and accountability and a short-term business oriented perspective–, all the more due to China’s apparent willingness to modernise its approach.

Beyond the BRI: providing a sustainable model of infrastructure governance

Sustainability has already been a key future of former and existing EU and Japan individual connectivity strategies. This includes the EU’s 2018 Europe–Asia Strategy on connectivity, focusing on ‘sustainable’ and ‘rules-based’ connectivity, ‘high standards of transparency and good governance’, a ‘level playing field’ and ‘open and transparent procurement processes’. Japan’s concept of Quality Infrastructure also reflected economic sustainability through ‘effective governance and economic efficiency’. Cooperation under the EU-Japan Partnership thus fosters convergence while building on the principles of ‘sustainability’, ‘quality infrastructure’ and a ‘level playing field’. This further translates into a support for an ‘open, rules-based, fair, [and] non-discriminatory (...) trade and investment’ and ‘transparent procurement practices’, marking a clear departure from the Belt and Road Initiative (BRI) and China’s way of financing infrastructure projects.

In fact, Beijing’s bilateral approach has been associated with a significant lack of transparency and evolving but insufficient standards that still hinder the BRI’s contribution to development as well as its financial, social and environmental sustainability. To date, the initiative has gathered more than US\$100 billion of troubled assets, more than a quarter of the world total since 2005. Although the BRI is unlikely to cause a systemic debt problem, eight of the 68 participating countries in 2018 were facing BRI-related debt sustainability issues. This includes Laos and the Boten-Vientiane Railway project, with an overall cost amounting to half the country’s Gross Domestic Product (GDP), and Montenegro, where the first phase of the Bar-Belgrade Motorway

amounted to 25% of the country's GDP, while increasing public debt to 83% of the latter. The Hambantota port project in Sri Lanka provides another –publicised– case of the BRI project's financial shortfalls. Although not a significant example of 'debt-trap' (but the symptom of an external sector crisis mainly unrelated to Chinese loans), the project's financial viability proved rather limited, with operating losses until 2016 when it only registered a profit of US\$1.81 million. By comparison, annual loan repayments amounted to US\$100 million. Financial unsustainability has created issues not only for borrowing countries but also for Chinese players. The Addis-Djibouti railway project, opened to commercial service in January 2018, has fallen short in both activity and revenues. Not only has the Ethiopian Railway Corporation been unable to finance loan repayments and management fees, but the Chinese insurance company Sinosure has also reported a US\$1 billion loss.

Early Chinese infrastructure projects, particularly in South-East Asia, have also shown low social standards, including lack of transparency or a failure to consult local populations. Nevertheless, this state of affairs seems to be evolving towards enhanced social norms and even a widespread adoption of international social safeguards. China's display of leadership in climate action, through its commitments to the Paris Agreement and the reduction of domestic emissions, is also a welcome development. But the greening of the BRI is yet to be achieved. Under the initiative, renewable energy power plants account for the majority of the US\$50 billion disbursed in the energy sector, but fossil-fuel energy generation projects still account for US\$15 billion. Indeed, China continues to invest heavily in coal power projects, financing over 50% of all global coal power capacity currently under development and jeopardising both environmental and financial sustainability. Estimates suggest that two-fifths of China's coal power stations are currently loss-making, a figure likely to rise to 95% by 2040. The BRI may cause similar issues for host countries. In fact, nearly 75% of the generation capacity of the China-Pakistan Economic Corridor (CPEC) –a cornerstone of China's development cooperation– will be coal fired. This may not only contradict China's promotion of green development but ultimately divert Pakistan from cheaper and cleaner energy sources: at present coal-project levelised tariffs are higher than those of wind or solar projects.

Beyond sustainability, the BRI is also fundamentally far from constituting a 'level-playing field' initiative. Chinese financing is most often tied to the attribution of projects to Chinese companies and the provision of Chinese goods and services. This results in the exclusion of non-Chinese companies from public tenders and prevents economic competition, affecting the interests of EU and Japanese firms. Moreover, it also threatens economic and financial effectiveness by disrupting competitive processes that might encourage the most efficient actors and allowing recipient authorities to spend funds inefficiently. Ultimately, tied aid casts doubts on the real competitiveness of Chinese firms that do not abide by the rules of competition. Hence, the explicit contrast made by some of the high-level officials that participated in the EU-Asia Connectivity Forum in September 2019 between high-standard connectivity initiatives, embodied in the EU-Japan framework for high-quality and sustainable connectivity, and the infrastructure and connectivity projects sponsored by China. At the same Forum, the EU authorities said that cooperation with China would require reciprocity, fair competition and public procurement, while calling for the multilateralisation of the Belt and Road Initiative.

Nevertheless, despite the positive normative and practical prospects of the EU-Japan Partnership, a significant implementation challenge remains to provide a real alternative to the BRI.

Expectations of implementation: securing financial commitment and inclusive cooperation

Achieving the full potential of the EU-Japan partnership would require moving from a normative approach to a concrete and effective implementation. This would mostly involve mobilising sufficient investment through cooperation with the private sector and other key public actors. Above all, the impact of the EU-Japan partnership would depend on the financial resources to be mobilised. Indeed, the volume of projects implemented on the basis of the principles that inspire the EU-Japan partnership on connectivity will be key in determining the initiative's capacity to influence other actors, such as China, at the normative level.

Hopefully, Japan has stood out as a particularly keen 'likeminded' country at the time to respond to the financial challenge posed by the enormous infrastructure demand of BRI countries, rapidly increasing the investments allocated to the Partnerships for Quality Infrastructure up to US\$200 billion. The latter encompass numerous projects such as the US\$3.7 billion port and power station in Matarbari, Bangladesh, and the over US\$10 billion Mumbai-Ahmedabad high-speed rail corridor. The EU's financial engagement in Asia is also expected to rise, as it has already decided to devote €60 billion to its EU-Asia connectivity plan, as well as €123 billion in 2021-30 to the Asian region overall. Joint or coordinated future EU-Japan investments should benefit from the Memorandums of Understanding (MoU) signed between the European Investment Bank (EIB) and the Japan Bank for International Cooperation (JBIC), the Nippon Export and Investment Insurance (NEXI) and the Japanese International Cooperation Agency (JICA) aimed at extending loans for infrastructure projects in Asia, the Middle East and Africa. These could prove to be useful tools to ensure a sustained EU-Japan financial engagement with connectivity projects and offer a credible alternative to the anticipated US\$1 trillion investment under the Belt and Road Initiative, including more than US\$160 billion in ASEAN countries and US\$12 billion in the Western Balkans (two strategic areas mentioned by the EU-Japan Partnership). By comparison, over 2015-20 period, EU support for infrastructure development in the Western Balkans was limited to a US\$1 billion grant, with an additional €5.5 billion associated loans under the Western Balkans Investment Framework (WBIF).

However, mirroring the BRI does not imply an exclusive competition with the initiative, and the preference for likeminded countries does not preclude cooperation with China. Rather, cooperation with China on connectivity projects might prove to be an opportunity to enhance the institutional standards of the participating Chinese players and the normative standards of the BRI projects. EU officials seem particularly keen to overcome actual difficulties and achieve cooperation with Chinese partners in connectivity projects outside the EU, mainly due to the persisting gap in achieving related SDGs whose global implementation would require an annual US\$2.5 trillion to US\$3 trillion, far beyond the EU or Japan's own capacities. They also adhere to the rationale that the EU-Japan Partnership might pressure China to engage with the EU on third-country cooperation,

not to be outcompeted by Japan. As reflected during the Europe-Asia Connectivity Forum, they share the perception that EU and China –including SOE banks– are moving towards a growing consensus on sustainability; this holds true at the political level although it is yet to materialise into specific project cooperation.

There has indeed been a normative alignment of the Chinese authorities on the concept of ‘high quality’ and ‘sustainable’ connectivity, which became keywords during the Second Belt and Road Forum in April 2019. In that same month, China’s Ministry of Finance published a Debt Sustainability Framework for Participating Countries of the BRI, referring to the IMF/World Bank own Debt Sustainability Framework for Low Income Countries and aiming at sustainable and inclusive growth. But it still remains far from clear whether the BRI would actually work as a multilateral initiative open to effective engagement with EU and Japanese players that could then have more leverage as regards the standards and quality of the BRI projects. The expectations surrounding the EU-Chinese bilateral Connectivity Platform have been short lived, and Japan’s conditions to adhere to the BRI –openness, transparency, economic sustainability and the ability of the developing countries involved to claim financial ownership over the projects in question– could prevent Sino-Japanese cooperation. The implementation of the 52 MOUs signed following the Japan-China Forum on Third Country Business Cooperation Attention would prove to be a significant test for cooperation with China, as well as an opportunity to gather experience and share best and worst practices on cooperation with China between the EU and Japan.

EU-Japanese cooperation with China could also build on a shared interest in attracting private investment to connectivity projects. Multilateral Development Banks have repeatedly highlighted that private investment is essential to bridge the connectivity gap. China has already expressed its interest in ‘encouraging greater co-operation between government and private capital’. There is indeed significant room for improvement as less than 10% of the BRI’s infrastructure-financing comes from private sources, well below the 20%-25% average in emerging markets. The EU-Japan Partnership explicitly addresses this issue as it aims to ‘spur private investment’ and the ‘engagement of the private sector’ to finance sustainable connectivity, while identifying the MoU between the EIB and the JICA as a useful tool for that purpose. Besides, within the Asian Development Bank, Japan is supporting private-led infrastructure projects including public-private partnerships (PPP). Involving the private sector would not only fulfil a multi-stakeholder approach but also ensure a non-competitive framework of engagement with China. Multilateral institutions, including the ADB, the EBRD and the EIB, have repeatedly pointed out the scale of connectivity financing needs would preclude a competition dynamic with China. Nevertheless, China’s loans-focused approach, in addition to heavily constraining third-country resources, might also prove more competitive, by limiting these countries’ fiscal capacity to engage in alternative connectivity initiatives; this would not apply under a (private) investment-led approach.

Finally, ensuring the inclusiveness of the EU-Japan Partnership, especially towards China and the BRI, may very well be an added attraction and a condition to be genuinely endorsed by third countries. Indeed, South-East Asian officials have repeatedly professed their desire to participate in different connectivity initiatives, avoiding hegemonic and exclusive approaches to connectivity. Attractiveness would certainly

depend on the financial resources provided by the EU and Japan, but also on effective promotion and branding, which could, in a certain way, be drawn from the BRI. There is a need to better communicate on EU and Japanese development assistance and to increase its visibility, especially in neighbouring and strategic regions, like the Balkans and South-East Asia. Hence the significance of platforms like the EU Connectivity Forum to reach potential partners and a broader audience. Reformed and evolved development practices might also make EU-Japanese cooperation more attractive and competitive. Japan has effectively reacted to the loss of transport projects to China by shortening and simplifying application procedures, reducing required government funding guarantees and reforming JBIC regulations to allow risky infrastructure investments.

Inclusiveness towards China and private actors would be facilitated if the EU and Japan were to reinforce, first, the cooperation between them and with other like-minded countries. As the EU and Japan aim to build synergies and coordinate their respective connectivity initiatives with third countries, they should focus on areas where they benefit from the greatest influence and strategic stakes, notably the Western Balkans, Africa and the Indo-Pacific. Japanese infrastructure investments are particularly high in South-East Asia and amounted to US\$230 billion from 2000 to 2017. Japan has also been particularly reactive to Chinese engagement and growing influence in the Mekong area. Likewise, the EU and EU member states are significant players in Africa, the Balkans and Latin America. The EU-Japan Partnership might not only benefit from a clear and focused strategic orientation, rather than from all-out global engagement, but also from each partner's experience and historical engagement in particular areas, potentially calling for a subsidiarity-like approach.

EU and Japanese cooperation could learn from, if not extend to, connectivity cooperation between Japan and India, especially the Asia-Africa Growth Corridor (AAGC) that endorsed the concept of 'quality infrastructure'. This would build on shared interests and perspectives on connectivity as well as on a common promotion of a rule-based multilateral order. Trilateral cooperation could start through strategic high-level dialogue, followed by the mobilisation of public and private financial resources, eventually extending beyond connectivity to encompass security cooperation in the Indo-Pacific, which would benefit the EU's credibility as a global foreign and security actor. There is also room for cooperation between local governments through city-pairing initiatives and sharing experiences in sustainable urban planning and urban governance. Finally, the EU's particular institutional structure would also call for coordination within EU countries themselves, optimising each country's relative assets, although this might also call for certain political compromises. As for engaging in Africa or Latin America, this would require taking advantage of France and Spain's historical economic and political ties, while sectoral expertise, such as the Dutch development of port and hinterland connectivity infrastructure, might echo India's connectivity agenda.

Conclusions

A turning point for leadership in multilateralism

The EU-Japan Partnership on Sustainable Connectivity and Quality Infrastructure opens up a new stage for bilateral cooperation, further strengthening the shared commitment to a multilateral and rules-based international order. It offers an accurate response to the

global connectivity challenge, while providing a distinctive contribution in comparison with the BRI thanks to the principles of sustainability and a level-playing field. This is not to say that the partnership is being built against China's initiative. Both the EU and Japan acknowledge the current and potential benefits of China's infrastructure development, including the achievement of the SDGs. Moreover, both the EU and Japan are willing to cooperate with China on connectivity projects as long as they are sustainable and offer a level-playing for the participation of private actors.

The EU-Japan partnership can cover the BRI's current shortfalls, that have resulted in concerns about financial, social, environmental and climate sustainability. It also addresses the lack of competition and of a level-playing field under the Chinese initiative, which precludes an efficient use of the financial resources devoted to BRI projects and hinders the participation of European and Japanese companies. Ultimately, the EU-Japan Partnership on connectivity should be better suited to the EU's and Japan's interests, providing a fair competition environment for its companies and contributing to the stability and prosperity of priority regions for their external action.

Nevertheless, crucial implementation challenges lie ahead, including the need to ensure significant and sustained European and Japanese financial commitment, the mobilisation of the private sector and the multilateralisation of the initiative through joint connectivity projects with other public actors willing to share the principles of sustainability and a level-playing field.

Positive prospects and significant challenges highlight that both the EU and Japan face a turning point and the responsibility to provide sustainable economic cooperation while finding the right balance between high-quality standards and much-needed quantity.