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Before the House Committee on Foreign Affairs, Subcommittee on Asia and the Pacific
"Development Finance in Asia: U.S. Economic Strategy Amid China's Belt and Road"
Wednesday, November 15, 2017

Chairman Yoho, Ranking Member Sherman, and Distinguished Members of the Subcommittee:

Thank you for the invitation to testify on the vital role of U.S. development initiatives in promoting security and opportunity in Asia especially amid China's One Belt, One Road (OBOR) initiative. It is always an honor to testify before this subcommittee especially alongside such distinguished colleagues. I would like to be clear that the views I express today are my own.

This morning, the bipartisan U.S.-China Economic & Security Review Commission, on which I serve as a Commissioner, submitted to Congress its 2017 Annual Report. The Commission is tasked by Congress to examine the national security implications of the trade and economic relationship between the U.S. and China including a focus on China's foreign policy priorities.

This year we spent some time analyzing the One Belt, One Road initiative. We conclude that Chinese President Xi Jinping is expanding China's presence on the world stage through both coercion and a charm offensive, thereby creating pockets of influence, leverage and control from the East and South China seas to Africa to Europe. The charm offensive is typified by One Belt, One Road which seeks to bring in more than 60 countries into China's economic and strategic orbit.[1]

As President Donald Trump returns from Asia today, China is marshalling the full resources of its state and private sector in an attempt to shape the Asia-Pacific region in a way that places China at the center of economic and security activity in the region. I believe that the U.S. needs a new strong, coordinated economic and development policy for Asia in order to effectively compete with China's growing investment and influence in the Asia-Pacific region.

In my view, the discussion about U.S. economic engagement in Asia is overly-focused on trade policy. This dialogue has not adequately taken into account essential development financing and foreign assistance tools that are some of our greatest strengths. Make no mistake that China's leaders recognize the value of economic engagement as they have little interest in any further opening of their domestic consumer market to Asia or the world.

A new U.S. economic strategy for Asia should prioritize development financing and our foreign assistance tools in a strategic way, coordinated with our allies and partners, in order to advance our national interest in a stable, prosperous and democratic Asia-Pacific region. Further, Asian countries continue to be wary of a U.S. strategy that is too focused on military relations. A better balance between U.S. security and economic activities in Asia would strengthen the effectiveness of both endeavors.

The Asia-Pacific Region is the Future

The Asia-Pacific region, including India, is absolutely vital to the security and prosperity of the American people. It is the most dynamic and one of the youngest and fastest growing regions of the world with four of the five projected highest growth rate countries: China, India, Indonesia, and the Philippines. In the next five years nearly half of all growth outside the U.S. will happen in Asia. By 2050, the region's share of world GDP will double and it will be half of the world's GDP.

Vice President Mike Pence noted during his April 2017 visit to the ASEAN Secretariat that "U.S. companies invest more in ASEAN and its members than any other part of Asia, nearly $274 billion, which is more than our investment in China, India, and Japan combined."[2] Further, we know that ASEAN countries are responsible for over half a million U.S. jobs, with the potential for more. Among ASEAN's 630 million citizens, the middle class is exploding and has tremendous potential growth as a consumer market for U.S. exports.[3]

In the coming years, the countries of this region will play an increasingly pivotal role in world affairs. The question is not *whether*, but *how* the Asia-Pacific region develops. The type of development can make the difference between economic growth that is lasting and economic growth that is fleeting. Between cities powered by clean, sustainable energy sources versus suffocating pollution in overwhelmed urban areas. Between a generation that grows up illiterate and malnourished, or one that is educated, healthy and breaks free from the cycle of poverty. Between an oppressed populace with no hope for the future, or one empowered to unlock its full potential.

The decisions these countries make will impact our economy and jobs, the air we all breathe, the water we all drink, human health, the world's food supply, and whether our planet is plagued by conflict or if there is peace and stability. Americans are safer and stronger at home when fewer people face destitution, when our trading partners are flourishing, when nations around the world can withstand crises, and when societies are freer, more democratic, and more inclusive. There are competing models of development out there and it is essential to our future that the Asia-Pacific region develops in a way that will best produce stability, prosperity, democracy, and human rights.

Today, it seems every country has an economic strategy for the Asia-Pacific region. The U.S. had the "Pivot" or the "Rebalance," India has an "Act East" policy, Taiwan has a "New Southbound Policy," and China has its "One Belt, One Road" initiative. While President Trump's speech last week in Vietnam included some good ideas, it is past time for the Administration to produce a substantive economic strategy for this important region if we are to adequately protect our national security and strengthen our economy.

China's One Belt, One Road (OBOR) Initiative

In 2013, Chinese President Xi Jinping launched the OBOR initiative as a top economic and strategic foreign policy program. According to analysis from Fitch, OBOR includes $900 billion worth of projects (planned or already underway) with more to come.[4] Development financing for OBOR projects primarily originates from the China Development Bank (CDB) and the Export-Import Bank of China.

The CDB is the world's largest development bank and its assets dwarf those of the World Bank and other multilateral development banks. The CDB reportedly has available $1.6 trillion of assets and the state implicitly guarantees its debt. In 2014, China also established the Silk Road Fund with an endowment of $40 billion and the Asian Infrastructure Investment Bank (AIIB) authorized to spend up to $250 billion. Key aspects of China's global development initiatives include:

Source: Galina Petrovskaya,"'Silk Road'" in EU: Trans-Caspian Transit Bypassing Russia," Deutsche Welle, September 3, 2016. Translation.

- **Relieving China's overcapacity in slowing domestic industrial and construction sectors.** OBOR's heavy focus on infrastructure creates an outlet for this tremendous capacity and allows the Chinese government to postpone difficult economic reforms such as privatizing its state-owned companies. In short, China builds the infrastructure with its own materials and workers and sends the recipient country the bill for it later.

- **Expanding China's access to strategically important maritime and overland trade routes.** In 2015-2016, Chinese companies announced plans to purchase or invest in $20 billion worth of port infrastructure around the world.[5] Chinese investments in port infrastructure associated with OBOR potentially could pave the way for Chinese naval access to key areas in the Indian Ocean region. In August 2017, China officially opened its first permanent overseas military base in Djibouti, a small country on the Horn of Africa located close to Camp Lemonnier – one of the largest and most critical U.S. military installations abroad.

- **Enhancing China's energy security strategy.** Approximately 70 percent of China's energy imports arrive from the Middle East and West Africa by passing through the narrow Strait of Malacca. Chinese energy development projects are designed to diversify how its energy imports arrive to China. Key projects include the Central Asian oil and gas pipelines, the $54 billion China-Pakistan Economic Corridor, and a new pipeline from China to the Indian Ocean through Burma with a deep water port in Rakhine, near where Burma's Rohingya population are suffering and being driven out of the country.

- **Gaining influence and leverage over other countries and countering U.S. influence.** The Chinese government has already shown a propensity for using economic coercion to pressure foreign governments. Examples include retaliating against South Korean companies in China over deployment of the U.S. Terminal High-Altitude Area Defense (THAAD) missile defense system, suspending communication and people-to-people exchanges with Taiwan over the “One China” policy, and cutting off imports of bananas and other farm products from the Philippines to protest Manila’s challenge to China’s activities in the South China Sea.

- **Placing China at the center of future economic and trade activity in Asia.** U.S. Defense Secretary James Mattis recently stated, “In a globalized world, there are many belts and many roads, and no one nation should put itself into a position of dictating ‘one belt, one road.’” Infrastructure projects such as the Kunming-Singapore railway network funded by China will direct more trade to China.

- **Taking advantage of low standards on transparency and accountability leading a higher debt burden for developing countries and less opportunities for U.S. companies.** China’s economic engagement is not transparent and can foster corruption. Combined with government subsidies from Beijing and low interest rates from the People’s Bank of China, it is increasingly difficult for American and other international firms to compete with China in one of the fastest growing regions of the world.

Chinese regional projects also focus on economic growth at the expense of political liberalization and can create instability by imposing high social, environmental and food security costs, especially in the Lower Mekong River region. The social and environmental impacts of China’s infrastructure projects are often an after-thought. Further, the loans are on terms advantageous to China and often predatory in nature, which in effect can create longer-term dependence on China. While the international community pursued debt forgiveness for poor countries decades ago, it seems that China is burdening low income countries with debt all over again.

Limitations of China’s Development Model

For the most part, Asian governments want Chinese investment but they would prefer more competition and higher quality options. China often uses the term “win, win” to describe its economic activities in the developing world. Asian officials sometimes joke that “win, win” usually means China wins two times. Asian countries are wary of Chinese dominance and generally would like to see more U.S. economic involvement in the region.

Throughout the world, Chinese investment has sparked backlash because its development model seems to be exploitative because it primarily focuses on benefitting Chinese businesses, employing Chinese workers, and extracting valuable resources for China’s use, while at the same time often facilitating corruption, displacing communities and harming the environment. Examples of backlash include:

- The Myitsone Dam in Burma is a $3.6 billion hydropower project on the Irrawaddy River that stipulated 90 percent of the dam’s power to be sent to China and required the resettlement of thousands of people. This deeply unpopular project was suspended in 2011 and China continues to seek compensation for $800 million in contractual obligations.
- In Sri Lanka, there have been violent protests against Chinese port projects that are designed to be controlled by China while displacing people and increasing Sri Lanka’s debt to China.
- The Thailand-China railway through Laos was subject to years of delay due to China’s insistence on acquiring land concessions and employing Chinese rather than Thai workers.
- The Areng Valley Dam in Cambodia was to be constructed in a protected forest but protesting citizens forced the cancellation of those plans.

It would be difficult and expensive for the U.S. to compete with China dollar-for-dollar on infrastructure development, but due to the limitations of the effectiveness of China's development approach, it isn't necessary. The U.S. can compete with China with fewer dollars and greater effectiveness if resources are used in a strategic way in the region. The U.S. should consider the following recommendations:

Recommendations

First, the Trump Administration and the U.S. Congress should increase economic and development assistance to key countries in the East Asia-Pacific region commensurate with their importance to U.S. strategic, economic and political interests. Currently, the region only receives 3 percent of all non-military U.S. foreign assistance. These low levels ensure that efforts to compete with China in Asia are vastly underfunded. Making matters worse, the FY18 Trump Administration budget request included about a 40 percent cut to U.S. development assistance to the East Asia-Pacific region. If the Trump Administration budget request were to be enacted it would drastically weaken U.S. engagement and influence, undercut our allies and partners, and force more Asian countries to become more dependent on Chinese initiatives.

USAID is the most effective development institution on the planet in alleviating extreme poverty, promoting resilient democratic societies, and advancing U.S. interests of stability and prosperity in the developing world. Today's modern USAID utilizes a new model of development that leverages the private sector, science, innovation and regional solutions.

The best way to compete with Chinese investment in the Asia-Pacific region is to play to our strengths by increasing and allocating development assistance in a more strategic way. The U.S should also better coordinate efforts with our allies and partners in the region and then provide the needed resources to increase our competitive advantage including global health, fighting pandemics and infectious diseases, humanitarian assistance, disaster relief, food security, environmental protection, and governance and rule of law initiatives that promote a stable economies and democracies.

Second, the U.S. should provide stronger support for the institutions that are best positioned to compete with China on infrastructure, including the Asian Development Bank (ADB), the World Bank, the Overseas Private Investment Corporation (OPIC) and the U.S. Export-Import Bank to name a few.

China, Japan, and South Korea have been the leaders in the Asia-Pacific infrastructure sector and this is an area where the U.S. does not have a comparative advantage. That said, it is in the U.S. national interest for the Asia-Pacific region to be economically connected in a way that isn't dominated by any one particular country, promotes inclusive economic growth, provides high standards of efficiency and sustainability, and employs strong social and environmental safeguards.

In the last week, President Trump stated that he would push for the World Bank and the Asian Development Bank to fund additional infrastructure development in Asia. The Administration also announced that OPIC and U.S. Trade and Development Agency (TDA) have signed Memorandums of Understanding with Japan to promote infrastructure investments abroad.[6] Even though details have not been provided, these small steps seem to be going in the right direction.

Unfortunately, these announcements are not consistent with the Trump Administration's FY18 budget request that zeroed out OPIC, reduced funding for the World Bank, and cut the U.S. contribution to the Japan-led Asian Development Bank in half from approximately $99.2 million to $47.4 million. There is still time for the Congress to reverse these short-sighted cuts to the institutions that are best positioned to compete with China.

Further, Chairman Yoho and Armed Services Ranking Member Adam Smith have introduced the "Economic Growth and Development Act" (H.R. 2747) which would strengthen our development financing initiatives including OPIC. Congress should move forward with passing that legislation expeditiously. I also agree with recommendations from the U.S. Global Leadership Coalition that OPIC should be allowed to make limited investments and help build capacity in American-owned businesses operating in emerging economies. OPIC's portfolio and administrative caps should be raised in order to expand its presence in the Asia-Pacific region.[7]

Third, India should become a central component of an Asia-Pacific strategy. India shares our democratic values and we have overlapping strategic interests, particularly concern about China's policies in the region**.** The Trump Administration is on the right track with the "Indo-Pacific" region terminology and the resuscitation of the Quadrilateral Dialogue with democratic partners Japan, Australia and India last week. Moving forward, the U.S. should ensure there is a strong economic component of the Quadrilateral Dialogue, which is a good forum to discuss a set of policies to counter China's coercive economic and political policies in the region.

In addition, the U.S. should assist India with gaining membership in the Asia-Pacific Economic Cooperation (APEC) forum, support Prime Minister Narenda Modi's Act East policy, and help India with its own domestic development challenges. Of all those who live in extreme poverty in the world, 33 percent live in India. India's health, regional connectivity, and energy and electricity sectors must make progress if any Indo-Asia-Pacific strategy is to be successful. A strong India is in U.S. interests, and the U.S. should place a higher priority on helping India achieve its potential.

Fourth, a strong and unified ASEAN is in the strategic and economic best interests of the U.S. and the region. Strengthening and helping the ASEAN Secretariat become more effective should be a top priority. The U.S can do this by enhancing its support for initiatives such as the U.S.-ASEAN Connect initiative and the ASEAN Single Window to facilitate trade and provide better opportunities for U.S. businesses. U.S. efforts need to be strengthened to better assist ASEAN and APEC streamline customs clearance procedures, increase transparency, and lower costs for business, allowing increased U.S. jobs and business opportunities in our fourth largest export market. An effective and unified ASEAN would have more credibility and a better ability to push back against Chinese diplomatic and economic coercion.

Fifth, the State Department and USAID should provide consistent and robust support for the Lower Mekong Initiative (LMI), a diplomatic and development platform for the U.S. to partner with Burma, Cambodia, Laos, Thailand, and Vietnam to promote better cooperation in the Mekong River sub-region. The Mekong River is the lifeline and critical artery for transportation, agriculture and fishing for at least 60 million people. Chinese dams upriver are jeopardizing the food supply, livelihoods and the natural environment of the entire region.

Through the LMI, the U.S. can help these countries come together to analyze the impacts, support regional dialogues on fisheries management, and provide U.S. engineering expertise on the construction of “smart infrastructure” (i.e. dams and roads that minimize their impact on the environment). U.S. funding for the LMI has averaged approximately $4.2 million since 2009 but in 2016 the funding level dropped from $11.5 million to $3 million. Stable and more consistent support for the LMI would help these countries more effectively push back against policies that threaten the region.

Sixth, the U.S. Congress should create a “Countering Chinese Economic Influence Fund” modeled after the “Countering Russian Influence Fund” that received $100 million last year. While countering Russian influence should be a priority, it is important not to ignore China’s more methodical military and economic activities that are shaping the fastest growing region of the world. I would argue that China should receive at least as much priority as Russia. This fund could focus on providing additional bilateral assistance to countries in Asia that are having the most difficulties with China including support for civil society.

Seventh, the Congress should require the State Department, Treasury Department, Commerce Department, USAID, and relevant agencies to submit a plan to Congress for competing economically with China in the Asia-Pacific region. The annual Department of Defense Authorization bills regularly include a provision requiring the Secretary of Defense to develop a strategic plan that prioritizes efforts in the Indo-Asia-Pacific region. This requirement from Congress would force the Administration to better articulate its strategy and sharpen its policy and programs in the region.

In conclusion, Beijing’s main advantage has been that, for the last two decades, the U.S. has diverted its focus from Asia while pursuing challenges in the Middle East and elsewhere. The U.S. can no longer ignore the strategic competition that is under way in the Asia-Pacific region. The good news is that the U.S. has strong allies and partners in the region who welcome a more active U.S. role. The challenge now is for the Administration and Congress to develop a more effective strategy to compete with China and make sure it has the resources to be successful.

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END NOTES

[1] 2017 Report to Congress of the U.S.-China Economic & Security Review Commission, 115th Congress, November 2017.

[2] White House Office of the Vice President, *Remarks by the Vice President at ASEAN*, April 20, 2017; U.S.-ASEAN Business Council, “Investment: Asean is the Number One Destination for U.S. Investment in Asia.”

[3] Nina Haichigian, “ASEAN’s Golden Moment in a time of Crisis,” Foreign Policy, August 9, 2017. http://foreignpolicy.com/2017/08/09/aseans-golden-moment-trump-north-korea-china-trade/

[4] Peter Wells and Dan Weinland, “Fitch Warns on Expected Returns from One Belt, One Road,” Financial Times, January 25, 2017.

[5] James Kynge, “Chinese Purchases of Overseas Ports Top $20 billion in Past Year,” *Financial Times*, July 16, 2017.

[6] Isabel Reynolds, “As Donald Trump heads to China, US and Japan sign infrastructure deals,” Livemint, November 10, 2017. http://www.livemint.com/Politics/eClpXQ48EVL625oEkSyWYP/As-Donald-Trump-heads-to-China-US-and-Japan-sign-infrastruc.html

[7] Abhik K. Pramanik, “What Could the President’s Commitment to Reforming Development Finance Look Like?”, U.S. Global Leadership Coalition blog, November 10, 2017.