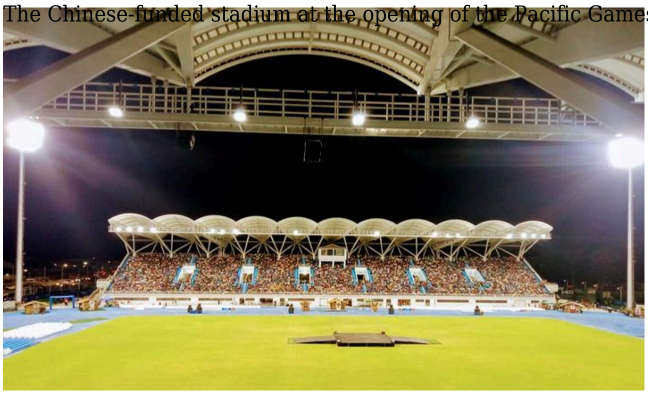
The Chinese-funded stadium at the opening of the Pacific Games



China’s shifting Pacific engagement – loud and brash to “small but beautiful”

By Alexandre Dayant and Riley Duke
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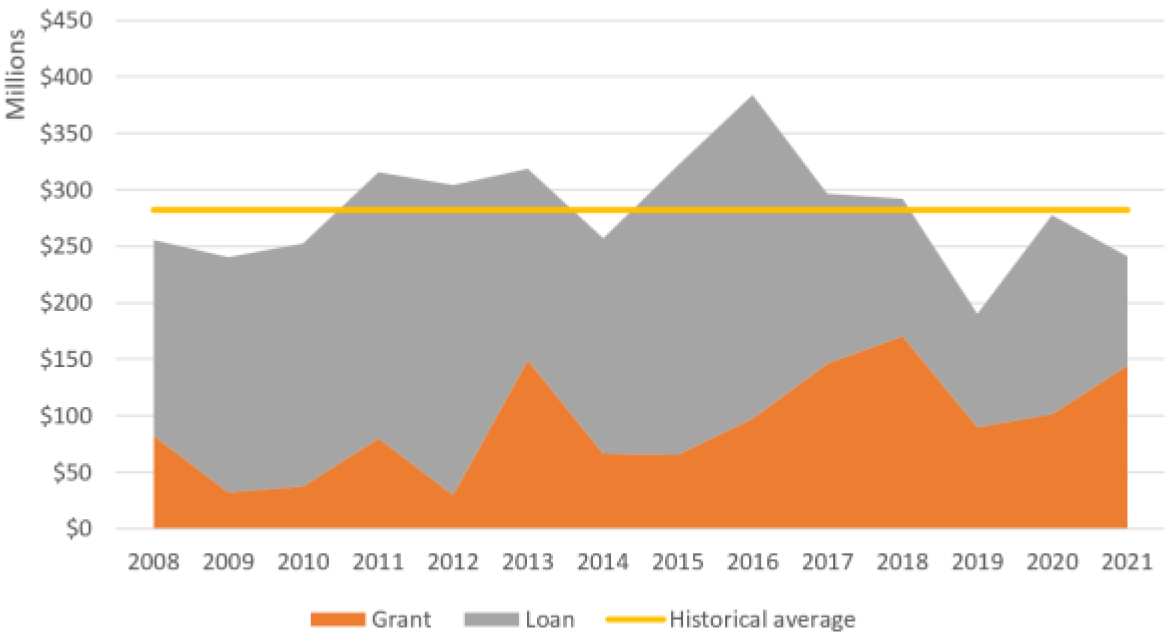
The 2023 Pacific Games are underway in Honiara. China, alongside several other countries, is contributing tens of millions of dollars to the cost of the event. Yet for China in the Pacific, support at this scale is becoming less common, as recent analysis points to a shift in Beijing’s regional strategy. Understanding the nature of this change, as well as its drivers, is key to understanding both China’s Pacific engagement and the broader outlook for the region’s development financing.

Over the last decade, China has emerged as a key development partner in the Pacific. Leading up to the COVID-19 pandemic, Beijing played a significant role as the region’s second largest source of development finance, behind Australia. Primarily, this support was delivered in the form of large debt-financed infrastructure projects, funded by China’s main policy banks – the Export-Import Bank of China and the China Development Bank. China was the first bilateral infrastructure financier.

While geopolitical tensions have continued to rise in the region, this has not been paralleled with increases in Chinese development spending. Recent data from the Pacific Aid Map reveals that Chinese financing in the Pacific hit a peak in 2016 and has gradually declined since. This decline has been further accentuated since the outbreak of the pandemic, resulting in a significant fall of new Chinese funding. In 2021, China’s total development finance disbursements dwindled to a mere US$241 million, falling below its pre-pandemic historical average of US$282 million per year. What’s more, Beijing’s most recent project financing commitments – which provide a good indication of China’s policy intentions and ambition – were just a quarter of the annual historical average.

Chinese official development finance in the Pacific (spent, constant 2021 US$)



Source: Lowy Institute [Pacific Aid Map]

This decline in Chinese financing within the Pacific has predominantly reflected a reduction in loans, as opposed to grants – a trend that can be attributed to several factors.

First, the drop in Chinese lending to the Pacific is in line with global trends. Since 2017, Beijing has tightened up capital controls and adopted stricter investment regulations to mitigate domestic financial risks. The Belt and Road Initiative (BRI) has also been approached with more caution due to concerns about investment risk, political instability, and project quality. Combined with China's own economic slowdown, these risk mitigation strategies have contributed to Beijing's reduced financing delivered internationally, as well as in the Pacific.

Second, stories of corruption associated with the BRI in the Pacific are numerous, and despite some project benefits, not all have unfolded as intended. Tonga, for instance, has grappled with repayment issues and requested extensions. In places like Fiji and Papua New Guinea, half-finished Chinese skyscrapers stand in disrepair. While these projects' outcomes have been impacted by a number of factors, the result nonetheless has been a deterioration in China's reputation. In turn, this has dampened demand for new Chinese-backed infrastructure projects in the Pacific.

Third, the infrastructure development financing landscape in the Pacific, where China focuses, has become increasingly contested. Back in 2008, China faced only a handful of competitors in financing infrastructure projects. Today, the scene is full of new players, from climate funds like the Green Climate Fund and the Global Green Growth Institute to Australia's Infrastructure Financing Facility for the Pacific (AIFFP). These donors often provide cost-effective infrastructure financing to accommodate the Pacific's tight fiscal constraints. For instance, by 2022, the AIFFP had committed over $784 million in predominantly concessionally financed infrastructure projects, resulting in a 77% surge in new infrastructure project commitments in the Pacific. As a result, China's share of development infrastructure spending has halved over the past decade, dropping from one-third to 15%.

However, this does not mean China is leaving the Pacific. Instead, China seems to be refining its approach, aiming to minimise risk and increase returns – both strategically and economically. For instance, China is increasingly concentrating its support on a smaller number of Pacific countries, committing substantial aid to nations like Solomon Islands and Kiribati, which shifted their diplomatic allegiance from Taiwan to China in 2019. In Solomon Islands, China has financed the flashy US$53 million 2023 Pacific Games stadium, as well as other sports facilities and administration buildings. More recently, Beijing committed to build 161 mobile communication towers, which will be supplied by Chinese telco giant Huawei. This would be Solomon Islands' first loan from Beijing since it switched diplomatic allegiance, and also China's largest project in the country.

Yet, it's likely that we will witness fewer similar projects in the region in the short term. In November 2021, China articulated the principles guiding the next phase of the BRI. One of the main focuses was on risk management for BRI projects. Beijing encouraged companies and their regulatory bodies to prioritise "small but beautiful" projects in international cooperation. As a result, China has shifted its emphasis away from large-scale infrastructure development finance. While the average size of Chinese projects in the Pacific Islands reached US$40 million between 2013 and 2019 – the first seven years of the BRI – recent years have witnessed a notable reduction, with project sizes averaging around US$5 million. Interestingly, the number of smaller projects has continued to rise, underscoring China's adoption of this new framework.

Chinese development finance may be unlikely to return to its earlier ambitious lending levels. China has indeed become a smaller development partner in the Pacific. Whether its financing is morphing to something beautiful remains to be seen.

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