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Reflections on IPEF's Regional Prosperity Pillar

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Driving regional prosperity is one of the five pillars of America's Indo-Pacific Strategy and has at its core the Indo-Pacific Economic Framework (IPEF). The IPEF covers a broad range of policies—trade, supply chains, “clean economy”, and “fair economy”—but this brief recommends: (a) that the IPEF could better reflect the core priorities of the Indo-Pacific developing countries (IPDCs); and (b) to finance these core priorities, the United States must leverage financing from multilateral development banks (MDBs) and reconsider its membership in the Asian Infrastructure Investment Bank (AIIB).

Vikram Nehru, Distinguished Practitioner-in-Residence at the Johns Hopkins University School of Advanced International Studies recommends that the IPEF better reflect the core priorities of developing countries in the Indo-Pacific and the United States finance these core priorities by leveraging multilateral development banks.

The IPEF Is Perhaps Too Comprehensive

The IPEF is unusually comprehensive. Virtually every policy associated with economic development seems to have been brought under its very broad chapeau. Comprehensiveness is to be admired, but, in this case, it raises two problems. First, most IPDCs have limited government capacity and do not have the bandwidth to design and implement reforms across a wide swath of policies. Second and, perhaps more importantly, IPEF's design seems to ignore two key lessons learned from many decades of development experience. First, given limited government capacity, developing countries must prioritize reforms that focus on the constraints binding their growth. And second, reforms that spur growth in one country often do not lead to desired growth outcomes in another. The successful economies in Asia, Korea, Japan, Taiwan, China, and even Singapore, have shown that to be successful, growth strategies need to be shaped by the domestic opportunities and constraints unique to each country. IPEF's four pillars, on the other hand, appear to be based on the belief that all IPDCs, despite their enormous diversity, have the same binding constraints to growth and, therefore, have similar reform priorities.

Can IPEF Drive Regional Prosperity?

This paper contends that IPDCs have different reform priorities. But there appear to be three binding constraints to growth that apply to several, if not all, IPDCs.

Human capital. Many Southeast Asian and South Asian countries face a shortage of skills and a substantial human capital deficit. Yet, human capital is the “new wealth of nations,” and it accounts for more than two-thirds of the Indo-Pacific's total wealth. Continued rapid growth in IPDCs will depend on how effectively these countries enhance their human capital.

Yet, surprisingly, human capital development is a concept that is largely absent in the IPEF. In the past, America's support for education in the Indo-Pacific has reaped impressive results. Take the Indian Institutes of Technology (IITs). These were modeled on America's MIT in the 1950s and have been a partner to American technology initiatives ever since. IITs have also been an important source of CEOs of major US corporations.

The challenge of improving education quality in IPDCs cannot be underestimated, but a concerted effort under US leadership can help accelerate progress. One priority could be “digital upskilling” to bolster the Indo-Pacific's rapidly expanding high-tech economy; another could encourage region-wide recognition of academic and technical credentials to permit the cross-border flow of skilled workers throughout the Indo-Pacific; a third could encourage IPDCs to expand foreign investment in higher education.

Climate change. A second long-term binding constraint, arguably even an existential threat, is climate change. The “clean pillar” of IPEF is designed to address this issue, and a key action point under this pillar is the Just Energy Transition Partnership (JETP). JETP comprises an international partnership group (IPG) of several advanced economies—formed under the leadership of the United States and co-chaired by Japan. The IPG provides financial

support to developing partner countries in exchange for commitments to reach net zero by 2050, among other energy transition goals. So far, the IPG has signed three JETP agreements – with South Africa, Indonesia, and Vietnam.

JETP agreements suffer from two shortcomings. First, they focus exclusively on mitigation when many IPDCs are among the world's most vulnerable to climate-induced extreme weather events. Second, the financial commitments underpinning the JETP agreements are a small fraction of the total funding needed to achieve the agreements' objectives.

Consider Vietnam. The IPG has committed \$15.5 billion for Vietnam's JETP, half to come from bilateral sources and half from the private sector. At the same time, the World Bank's July 2022 Climate Change and Development Report for Vietnam asserts that the undiscounted cost of climate change mitigation and adaptation for the period 2022-2040 comes to \$700 billion—\$483 billion for resilience, \$218 billion for decarbonization. These costs are equivalent to almost 200% of Vietnam's current GDP. Clearly, the JETP is severely underfunded, unless the United States expects Vietnam to shoulder this large financial burden on its own even though it contributes only 0.8% of greenhouse gas (GHG) emissions and accounts for only 0.2% of the stock of GHG emissions.

Infrastructure. A third binding constraint for many Indo-Pacific developing countries is infrastructure, especially transport and telecommunications. McKinsey estimates that to continue to grow well until 2035, developing Asia-Pacific countries (excluding China) will need to devote at least an additional \$800 billion a year to infrastructure investments.

The United States, together with its partners, is trying to fill part of this gap. Since 2015, the United States and other quad members have provided \$48 billion in official finance for high-quality infrastructure in the Indo-Pacific. The United States also supports infrastructure finance through the multilateral development banks and the US International Development Finance Corporation. Even so, taken in its entirety, US support for infrastructure financing in the Indo-Pacific must increase by multiples, perhaps even by an order of magnitude, if it is to be meaningful.

In stark comparison, China has actively financed infrastructure in developing Asia in amounts several times greater than the financing offered by advanced economies. Unfortunately, China does not provide reliable data on the amounts invested or the financial terms of its loans. But the debt crises faced by Sri Lanka, Pakistan, and now Lao PDR give cause for concern. They can be traced to recent sharp increases in debt servicing requirements on Chinese loans and are accelerating changes in the power dynamics of Asia. Unless the advanced nations can provide alternative funding sources in the amounts needed by IPDCs, other countries in the region may well meet the same fate.

IPEF Needs to Leverage MDBs

A common thread connects these three policy priorities in IPDCs. All require large amounts of financing that the United States seems unable, and perhaps unwilling, to provide. One solution would be to leverage the MDBs—especially the World Bank and the Asian Development Bank (ADB)—through a capital increase. In the past, expanding the World Bank's capital base has met political opposition in Congress. But with a new president-designate at the World Bank and the effectiveness of the IPEF at stake, perhaps the time is ripe to fashion bipartisan support for this effort. A US contribution toward an increase in the World Bank's capital would trigger capital contributions from all member countries, and the World Bank could leverage this manifold by borrowing in capital markets and crowding-in finance from the private sector. Additionally, the United States should reconsider its stance toward membership in the Asian Infrastructure Investment Bank (AIIB); joining the institution will boost AIIB financing for infrastructure in IPDCs, and the United States would then be better positioned to shape that support.

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