

Is China's increased diplomatic and economic influence in Oceania a threat to American good governance goals in the region?

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## **Introduction**

China's Belt and Road Initiative and increasing activity in the developing world have given rise to a legion of discussions and fears about their ultimate intentions. Theories range from peaceful and cooperative expansion of trade to complete global domination. As China expands eastward into the Pacific, it has taken an active role in providing aid to Pacific island nations. The most cynical analysts see these aid packages as either efforts to supplant western government influence, or schemes to drive weak nations into debt and thereby control their foreign policy. The real effect of this aid on small nations has not been fully studied, except for the most obvious economic aspects.

Oceania provides an excellent backdrop for studying Chinese foreign policy for a number of reasons. First, the nations of Oceania are very similar to one another in terms of resources and access to markets, giving them similar economic opportunities. Second, they have generally small economies of which aid is a major part. For that reason, the impacts of aid should be more observable. Third, due to small populations and size, their ability to absorb and process aid is more easily saturated, making zero-sum situations more likely than elsewhere in the world. Fourth, the countries of Oceania have diverse relationships with China, allowing differing diplomatic and economic situations as a variable for study. Finally, the Pacific islands are strategically important to the United States due to their position along trade routes, the proximity of major allies, the existence of three Compacts of Free Association (COFA), and the presence of numerous U.S. possessions and territories.

The impact of aid is usually examined through the lens of economic development or related quality of life benefits to the population. The impact on government transparency, accountability, efficiency, and ability or willingness to fight corruption has not been fully

evaluated. Yet major multinational development organizations such as the World Bank and International Monetary Fund attach governance stipulations to their aid, as do the governments of most western countries. These stipulations are intended to ensure proper distribution of the aid, and to encourage government reform. China, on the other hand, has become a popular partner of developing countries specifically because it does not attach any such requirements. Chinese aid and lending are seen as easier and faster due to coming with less red tape. Many assume that because China does not require good governance in aid recipients, they are providing a way to bypass reforms, and thereby increasing corruption worldwide.

This paper will answer the question: Is China's increased diplomatic and economic influence in Oceania a threat to American good governance goals in the region? By consolidating data on governance measures and comparing it to Chinese government aid allocations, patterns will be analyzed to determine whether Chinese funding has a negative impact. The investigation will look at governance trends over time, as well as identifying spikes related to particularly large projects. The results indicate no clear relationship between Chinese aid and changes in governance. Increased aid from the PRC does not consistently result in more corrupt governments. In fact, governance appears just as likely to improve. Furthermore, there are several instances when governance declines in the midst of high levels of U.S. and allied aid, indicating that efforts to improve governance with aid conditions are not always effective.

Oceania will be analyzed in three groups depending on the closeness of their ties to China. Group one consists of countries for which China is the major aid donor, and also the main holder of national debt. Group two contains countries that receive varying levels of Chinese aid, but also have larger relationships with another donor. Group three is made up of countries with no diplomatic relations with China and who receive no Chinese aid.

This paper proceeds as follows: In section one the existing literature on the relationship between China and Oceania is reviewed. Section two explains the country groupings, introduces the sources of data used, and illustrates the research method. Section three takes each country in turn to analyze the factors of governance and major aid donations. Section four is the conclusion.

### **Literature Review**

The inter-relation between the United States' (U.S.) and People's Republic of China's (PRC) policy goals in Oceania has been the subject of much speculation and debate. Among the most critical debates are: What are China's true intentions in the region; is increased involvement from China beneficial to the island nations themselves; and do China's goals or actions directly oppose those of the United States?

#### **What are China's goals in Oceania?**

In order to assess any potential conflict between U.S. and Chinese Pacific policy it is necessary to define China's goals in Oceania. Most researchers agree that China has two major strategic objectives: to gain access to resources and to gain political influence. In addition to timber and minerals from Papua New Guinea, China desires access to the 11.6 million square miles of ocean that is bounded by the exclusive economic zones (EEZ) of the Pacific island nations. Future technology will allow harvesting of seafloor minerals in that zone. Presently, the multi-billion dollar tuna industry is a powerful incentive and China would benefit from both access to Pacific island ports for their fishing fleet, and permission to fish legally in those waters. Secondly, and most importantly, China wishes to use political gains in the Pacific islands to

continue their campaign to isolate Taiwan from the international community.<sup>1</sup> Taiwan and China have engaged in so-called dollar diplomacy for decades in the region to curry favor and votes in international forums. Four of the twelve nations in Oceania still maintain diplomatic relations with Taiwan, with the Solomon Islands and Kiribati having switched allegiances to the PRC as recently as September 2019.<sup>2</sup>

Although China's primary objectives are understood, debates arise when trying to settle the underlying motivations. Terence Wesley-Smith is content to take China's goals at face value. He frequently references Chinese Premier Wen Jiabao's 2006 address to the China-Pacific Island Countries Economic Development and Cooperation Forum where he espoused a plan for harmonious and peaceful economic growth in the region. To Wesley-Smith, the attention that China pays to Oceania is no different than their policies in the rest of the developing world, particularly Africa and South America, where they have similar goals.<sup>3</sup> Michael Powles agrees with this assessment and emphasizes that China is unlikely to try to threaten America militarily in the region. He points out that Chinese actions are often reactionary to perceived U.S. policies of containment.<sup>4</sup> Chen Xiaochen agrees and takes this line of thinking a step further. For Chen, all Chinese policies are benevolent and seek to improve interconnectedness and well-being for the Pacific islands.<sup>5</sup> Taking into account the complete

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<sup>1</sup> Wesley-Smith, T. (2010). China's Pacific Engagement. In T. Wesley-Smith, & E. A. Porter (Eds.), *China in Oceania: Reshaping the Pacific?* (pp. 27-48). New York: Berghahn Books.;  
Henderson, J., & Reilly, B. (2003, Summer). Dragon in Paradise: China's Rising Star in Oceania. *The National Interest* (72), 94-105.;  
Schleich, D.-M. (2018, June). Geopolitical Trends in the South Pacific: Is the US or China Winning? *ISPSW Strategy Series: Focus on Defense and International Security* (556).;

<sup>2</sup> Lee, Y. (2019, November 21). *Tuvalu rejects China offer to build islands and retains ties with Taiwan*. Reuters.

<sup>3</sup> Wesley-Smith, China's Pacific Engagement, 2010.

<sup>4</sup> Powles, M. (2010). Challenges, Opportunities, and the Case for Engagement. In T. Wesley-Smith, & E. A. Porter (Eds.), *China in Oceania: Reshaping the Pacific?* New York: Berghahn Books.

<sup>5</sup> Chen, X. (2020, Jan 02). *China, the United States and Changing South Pacific Regional Order in the 2010s*. Peking University Institute of International and Strategic Studies (IISS).

one-sidedness of his writing and the fact that his work is published by Peking University, it can be assumed that it reflects Beijing's talking points to justify increased access.

John Henderson and Benjamin Reilly are much less convinced of China's benevolent intentions. They state rather bluntly that China seeks to supplant the United States as the main power in the region. Henderson and Reilly point to China's blue water naval ambitions as indicative of an expansionist mindset, although they admit that there are no indications that China seeks to conquer areas of the Pacific.<sup>6</sup> Dr. Anne-Marie Schleich also suggests that China is trying to undermine American interests. She points to the creation of alternate international forums, such as the above-mentioned China-Pacific Island Countries Economic Development and Cooperation Forum, to indicate that China is trying to subvert the U.S. and its allies by cutting them out of multilateral dialogues. She particularly emphasizes China's efforts to help Fiji create the Pacific Islands Development Forum in 2013 while Fiji was suspended from the Pacific Islands Forum on account of the 2006 coup.<sup>7</sup>

### **Is China's increased role in Oceania good for Pacific Island Nations?**

The second debate is whether increased Chinese involvement in Oceania is good for the Island Nations. Wesley-Smith and Porter believe that it is, pointing to the opportunities afforded by non-traditional and unconditional lending, and the generally positive reception to Chinese programs from Pacific island leaders.<sup>8</sup> Chen asserts that Chinese partnerships are more attuned to the needs of the islanders, and that China is helping them with issues that matter, namely the effects of climate change, and interconnected infrastructure.<sup>9</sup> Alex Lin and Saori Katada from

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<sup>6</sup> Henderson & Reilly, 2003.

<sup>7</sup> Schleich, 2018.

<sup>8</sup> Wesley-Smith, T., & Porter, E. A. (2010). Oceania Matters. In T. Wesley-Smith, & E. A. Porter (Eds.), *China in Oceania: Reshaping the Pacific?* (pp. 1-26). New York: Berghahn Books.

<sup>9</sup> Chen, 2020.

University of Southern California are cautiously optimistic that a way might be found to allow all parties to partake in joint trade agreements. In the meantime, they see Pacific islands as potentially benefitting from the increased attention and competition.<sup>10</sup> Denghua Zhang from Australia National University agrees and points out that programs provide different advantages: U.S. projects and aid are higher quality, while Chinese aid is more responsive.<sup>11</sup>

Schleich, on the other hand, reveals a major issue with Chinese aid. Eighty percent of Chinese aid is in the form of concessional loans rather than grants. Some have zero interest for up to 20 years, then a high interest rate. These can be very difficult for a small island economy to repay. Additionally, most Chinese aid is for infrastructure projects, but unlike western-funded projects they use Chinese manufacturing companies with all Chinese workers, meaning the benefit to the local economy is minimal.<sup>12</sup> These infrastructure projects are also funded by loans, meaning the nation takes out a loan, uses it to pay a Chinese company to build something, and then has to pay back the loan. Assuming the construction company is state-owned, the island essentially pays back the loan twice. Lastly, the resulting infrastructure is often of poor quality.<sup>13</sup>

Henderson and Reilly agree that Chinese aid projects provide little benefit to the local economy, but they admit that regional governments are still tempted to accept them due to frustration with traditional funding sources, saying that they provide too much criticism, and not enough of the projects they need.<sup>14</sup> Most recently, western governments have moved away from providing infrastructure, favoring capacity building, which may not be received as

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<sup>10</sup> Lin, A. Y.-T., & Katada, S. N. (2017, August 2). Regional Order Reconfigured: China, Japan, and the United States in the Evolving Asia Pacific. *Asia Pacific Bulletin* (390).

<sup>11</sup> Zhang, D. (2018). The US's Indo-Pacific Strategy: Implications for Pacific Island Countries. *Department of Pacific Affairs, In Brief* (21).

<sup>12</sup> Schleich, 2018.

<sup>13</sup> Lum & Vaughn, 2017.; Greenfield, C., & Barrett, J. (2018, August 1). Payment Due: Pacific Islands in the Red as Debts to China Mount. *Business Recorder*.

<sup>14</sup> Henderson & Reilly, 2003.

enthusiastically as a new government building, for instance.<sup>15</sup> Although many authors acknowledge the inconvenience felt by island governments from loans conditioned on good governance, only one considers whether principles of transparency, accountability, and government efficiency are good for the people of the islands. Wesley-Smith determined that they are not necessary. Due to the more personal style of government in the Pacific islands, he contends that leaders are held accountable without formal legal architecture. Externally imposed reforms are seen as interference with traditional practices by island governments, and are therefore unlikely to be embraced. Lastly he points to China as an example of a nation that has thrived economically without any of the proposed economic or governmental reforms, but he fails to note that China and the Pacific island nations could scarcely be more different in almost every factor.<sup>16</sup>

It is impossible to discuss Chinese development aid without touching on the debt trap issue. A report by Harvard graduate students Sam Parker and Gabrielle Chefitz concluded that China does not actively seek to drive countries into debt, but will take advantage of accumulated debt to achieve its diplomatic ends. They hypothesized that China could try to use debt to drive a wedge between the U.S. and COFA states when the compact is renegotiated in 2023.<sup>17</sup> The Lowy Institute's Roland Rajah, et al, specifically examined whether China was operating debt traps in Oceania. They established four criteria necessary to qualify lending as a debt trap: It must decrease debt sustainability in the region; China needs to become the dominant creditor; loans must be demonstrably more expensive than from other sources; and lending must be skewed towards countries already in debt. They then systematically showed that the latter three

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<sup>15</sup> Schleich, 2018.

<sup>16</sup> Wesley-Smith, *China's Pacific Engagement*, 2010.

<sup>17</sup> Parker, S., & Chefitz, G. (2018, May 24). *Debtbook Diplomacy*. Boston: Belfer Center for Science and International Affairs, Harvard Kennedy School.



criteria are not met by Chinese lending in the Pacific. In particular they found, unlike Schleich, that the terms of Chinese concessionary loans have improved in recent years and are in keeping with those of international funding sources enough to qualify as aid. Although debt sustainability is decreasing in Oceania, they found that it is not primarily due to PRC activity or policies. They concluded by listing ways that China can improve its lending practices to avoid debt trap accusations, such as further improving concessionary loan terms and mandating internal controls to prevent lending to debt-stressed countries.<sup>18</sup>

The impact of increased Chinese activity on Pacific fisheries was not discussed in depth. Around 20% of all fish worldwide are caught illegally, many by China's fishing fleet, which represents a loss of \$615 million each year for Pacific island nations who cannot effectively patrol their vast waters.<sup>19</sup> Whether illegal fishing will be affected by China's increased involvement in the region was not considered in these sources.

### **Is China's increased engagement compatible with American interests?**

Lastly, and most to the point, is the debate about whether increased engagement by China in Oceania is compatible with U.S. interests. The Free and Open Indo-Pacific strategy released in November 2019 emphasizes that "The U.S. Vision for the Indo-Pacific excludes no nation. We do not ask countries to choose between one partner or another".<sup>20</sup> However, not all researchers are likely to be fully convinced of that point based on the existing literature, and somewhat more aggressive language in the regional defense strategy.

U.S. priorities in the region fall into three categories: Economic development, security, and good governance. Economic development includes bilateral trade agreements, high-quality

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<sup>18</sup> Rajah, R., Dayant, A., & Pryke, J. (2019, October). *Ocean of Debt? Belt and Road and Dept Diplomacy in the Pacific*. Lowy Institute.

<sup>19</sup> Lum & Vaughn, 2017.

<sup>20</sup> U.S. Department of State. (2019, November 4). *A Free and Open Indo-Pacific: Advancing a Shared Vision*, 6.

infrastructure, and energy and digital improvements, although specific plans for Oceania are unclear. Security interests in Oceania involve freedom of the air and seas, enforcing international norms, and military basing rights. In order to promote these the U.S. intends to increase presence in the Compact of Free Association (COFA) states of Micronesia, the Marshall Islands, and Palau.<sup>21</sup> Good governance includes promoting free and open societies, and is the one part of the national strategy that directly confronts China for “practice[ing] repression at home and abroad”,<sup>22</sup> indicating that it will be a large point of contention.

Chen is the harshest critic of U.S. policies in Oceania. Citing Wesley-Smith, he criticizes America for the wide changes in policy between the Obama and Trump administrations. In particular he disparages the act of withdrawing from the Paris Climate Accords, considering that climate-related issues such as sea level rise and extreme weather are of vital importance to Pacific island nations. He strongly criticizes America for lack of clarity in how the Indo-Pacific Strategy will be executed, blaming the U.S. for heightening tensions.<sup>23</sup> Henderson and Reilly agree that the two nations’ policies are opposed, but put the blame on China actively seeking to remove U.S. influence from the region.<sup>24</sup> Like Chen, Zhang agrees that uncertainty over implementation of U.S. policy is causing confusion among Pacific partners, although they may benefit from playing both sides. He clearly paints the situation as a competition where Chinese condition-free loans are directly opposed to U.S. good governance goals.<sup>25</sup> Schleich, on the other hand, sees more competition over political influence garnered through economic aid. She demonstrates the sharp increase in Chinese aid since 2006, matching America in the region. She

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<sup>21</sup> U.S. Department of Defense. (2019, June 1). *Indo-Pacific Strategy Report*. Washington, DC.

<sup>22</sup> U.S. Department of State, 2019, p. 21.

<sup>23</sup> Chen, 2020.

<sup>24</sup> Henderson & Reilly, 2003.

<sup>25</sup> Zhang, 2018.

then indicates that China's position as a much larger trading partner than the U.S. with Pacific nations could be used in combination with debt leverage to allow them to oppose U.S. policies.<sup>26</sup>

On the other side of the debate, Lin and Katada conclude that the opposing theories of economic development and the creation of multiple forums, become a foundation for multilateral cooperation instead of exclusion. They do not think that the policies of the two nations are necessarily at odds.<sup>27</sup> Wesley-Smith is also a proponent of cooperation. To him, increased Chinese involvement in the region is primarily beneficial because it gives nations an option to skirt conditions on western aid. He does not believe there is any proof that China is a military threat and asserts (incorrectly) that no Pacific island nation is near any major shipping route. He points out that American interest in Oceania has primarily been north of the equator, which does not conflict with most Chinese efforts to the south.<sup>28</sup>

### **Approach to Resolve the Debate**

Although America's desire for continued strategic presence risks clashing with China's fear of being contained, the subject has been thoroughly examined and continues to evolve. A more significant contribution to the literature can be made by examining the apparent conflict between the U.S. strategic goal of promoting good governance and the impact of Chinese aid and investment. By offering condition-free loans China undercuts America's ability to use economic power to promote political change. It is also possible that the example of China's success will cause other nations to conclude, as Wesley-Smith did, that good governance is not necessary.<sup>29</sup> In order to determine the effect that this is having on U.S. goals, I will examine government transparency, accountability, and efficiency ratings over time, checking them against Chinese

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<sup>26</sup> Schleich, 2018.

<sup>27</sup> Lin & Katada, 2017.

<sup>28</sup> Wesley-Smith, China's Pacific Engagement, 2010.

<sup>29</sup> Ibid.

infrastructure projects, aid, and investments to see if a correlation can be found. If increased Chinese engagement has a negative effect on good governance practices, then it can be determined that U.S. and Chinese economic activities in Oceania are antithetical to each other.

### **Theory/Assumptions and Hypothesis**

The U.S. Indo-Pacific Strategy Report professes a free and open Pacific as the strategic goal of the United States. The opportunity to exercise national sovereignty without being coerced by other nations is what is meant by “free”, and requires good governance and individual liberties. The report goes on to allege that China is intentionally driving Pacific nations into debt in order to exercise political leverage over them.<sup>30</sup> As noted above, analysis of China’s supposed debt-trap diplomacy has found no evidence that it is true for the Pacific islands. It follows that if China is to have a negative effect on national sovereignty through economic means it is by reducing good governance and freedoms. This is possible by offering a way for countries to bypass the aid stipulations of other international lenders. Whether this is happening has not yet been analyzed.

I hypothesize that this is not the case. Chinese aid packages and development loans to the Pacific islands are in response to needs expressed by those governments. Pacific islands are capable of recognizing when a deal is predatory and are able to take advantage of competition between international donors to gain better deals. China does seek diplomatic cooperation, particularly with respect to preventing recognition of Taiwan, but its practices are less a matter of coercion and more a matter of incentivization – that is, they are using more carrot and less stick. Although it is true that China does not require government transparency or accountability in their

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<sup>30</sup> U.S. Department of Defense, 2019.

aid recipients, and may even benefit from the lack thereof in certain cases, there is no reason to think that they actively promote corruption.

### **Research Method**

To facilitate research, the countries of Oceania were divided into three groups based on the nature of their relationship with China. The first group contains countries where China is a significant source of aid funding including grants and loans, namely Samoa, Tonga, and Vanuatu. If China is a malign influence, the expectation based on U.S. strategic documents is that good governance efforts by the U.S. and allies would be ineffective in these countries, resulting in a net decrease in government effectiveness, transparency, and accountability proportional to the level of Chinese involvement.

The second group contains countries that receive varying amounts of aid from China, or that switched diplomatic relations from Taiwan to the PRC during the time period studied in order to be eligible for Chinese development. These countries are Fiji, the Federated States of Micronesia (FSM), and Kiribati. They will be examined for reductions in governance when their alliances switch from Taiwan to the PRC and following large Chinese aid projects. Of note, the Solomon Islands are not included in this grouping even though they switched relations to China in late 2019 because the impact of that change is not yet observable. Kiribati also recognized the PRC in 2019, but is included in this group due to their earlier diplomatic shift from the PRC to Taiwan in 2009.

The last group includes countries that received no Chinese aid whatsoever during the time period studied, namely the Solomon Islands, Tuvalu, and the Republic of the Marshall Islands (RMI). Group three acts as a control to demonstrate what is possible without Chinese

aid. These countries must rely on traditional lending and aid for development, and are therefore subject to conditions placed on that aid intended to promote good governance. Conventional wisdom would expect this to result in observable improvement in governance over time.

Five Oceania countries are excluded from the study. Australia and New Zealand are not included because they are strong, established governments, and are primary aid donors in the region. Papua New Guinea (PNG) was excluded due to the fact that it is very unlike the rest of Oceania. PNG has land borders, a large land mass and population, and significant natural resources. The extreme difference from the other nations examined makes objective comparisons difficult. It also means that there may be many variables affecting governance in PNG that do not exist in the other countries and are not evaluated in this study. PNG remains a standout in the region for its long-lasting and entrenched corruption, often ranking near the bottom of every index, making it difficult to show that any further Chinese investment will reduce governance, even the \$4 billion dollars pledged in 2017 for road construction.

Nauru and Palau are also excluded. Palau is an interesting case to study due to its status as a COFA state, and its being the object of economic pressure from China in the form of tourism restrictions. Nauru is also interesting due to the fact that it shifted diplomatic recognition from Taiwan to the PRC in 2002 in return for promises of Chinese aid, then broke ties and returned to Taiwan in 2005 when the Chinese aid failed to materialize. As the smallest country in Oceania at only eight square miles and 11,000 people, examining the impact of Nauru taking a stand against China is potentially fascinating. Unfortunately, both Palau and Nauru suffer from the neglect of data sources. They each were only tracked by Freedom House and half of the WGI indices until 2007. In that year the remaining three WGI indices were started, but a noticeable trend emerged in both countries where the older WGI measures decreased and

the new measures increased. This peculiar convergence happening in both countries may be statistical error owing to the fact that there is not much historical data. Although PNG, Nauru, and Palau were not fully evaluated, their data was collected and is included in the appendices.

This paper utilizes four organizations and thirteen databases tracking data related to factors of nations' governance in order to identify trends. Data was examined primarily from 2003 onward due to availability, which allowed the consideration of recent events, including increases in Chinese aid since 2006. Trends and significant changes in governance were identified from these sources and compared to information on Chinese aid and investments drawn from two databases and various news sources.

Challenges encountered included the limited inclusion of Pacific islands into governance databases. Not having each country included in each database makes consistent analysis difficult. Similarly, long term data is affected by changing research methods over the years. Many of those methods involve perception surveys which can be somewhat subjective, although the researchers try to control for that. These issues were mitigated by utilizing multiple sources and examining trends rather than the minutia of each numerical score.

## **Resources**

Perhaps the best-known source for governance data is Transparency International's Corruption Perception Index (CPI). The CPI compiles results of 13 surveys of business people and experts in corruption to issue a single numerical score indicating how corrupt a nation's government is perceived to be.<sup>31</sup> Unfortunately, the Pacific islands are very small markets and as such do not raise the level of interest necessary to be included consistently on the CPI. Only Papua New Guinea has been regularly examined. All other nations appeared sporadically or not

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<sup>31</sup> (Transparency International, 2020)

at all. The countries of highest interest to U.S. foreign policy, the COFA states, were completely excluded.

Freedom House provides a more inclusive analysis of each country with databases going back to the 1970's. Freedom House examines a series of questions and gives a numerical rating in seven categories, which are then compiled into numerical scores for political rights and civil liberties. As might be expected, Freedom House focuses largely on personal rights and political inclusivity, but functioning of government is a factor of the political rights score, and rule of law is a factor of civil liberties. A written report is also available for the years since 2016, providing helpful context for the numerical scores.<sup>32</sup>

In order to avoid over-reliance on Freedom House, another source was needed. The World Bank takes particular interest in the developing world and uses their Country Policy and Institutional Assessment (CPIA) to help assess which regions are more likely to yield profitable investments or successful development. Most of the factors in the CPIA are economic metrics, but six factors of good governance are included.<sup>33</sup> Doing business in a country with a corrupt government or where bribes are needed to do business raises the cost of investment and also makes expected returns unpredictable.<sup>34</sup> Like Transparency International, however, the World Bank's focus on regions with robust business and investment opportunity means that data on Oceania is sparse. Only half of the Pacific islands have enough information to establish multi-year trends. Data on the CPIA is also slow to update since it is based on the perceived risk of investing, sometimes lagging several years to register improvements in governance.<sup>35</sup> The

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<sup>32</sup> Freedom House. (2020). *Freedom in the World*.

<sup>33</sup> World Bank. (2020). *Country Policy and Institutional Assessment*.

<sup>34</sup> Friedman, T. L. (2000). *The Lexus and the Olive Tree: Understanding Globalization*. New York: Farrar, Straus and Girou.

<sup>35</sup> Collier, P. (2007). *The Bottom Billion*. Oxford: Oxford University Press.



existing data was incorporated into this study, but was still inadequate for a full examination of the region.

Fortunately, the World Bank Development Research Group in collaboration with the Brookings Institution and the Natural Resource Governance Institute created the Worldwide Governance Indicators (WGI) project evaluating over 200 countries. Using dozens of sources, the WGI evaluates nearly every country in the world in six factors: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption.<sup>36</sup> The WGI is the most comprehensive of the governance indices, providing long term trends and responsive metrics for the period of 1996-2018. Together with the three previous sources, the WGI completes the picture of governance in the Pacific islands.

Obtaining information on Chinese investments was expected to be the most challenging portion of this research paper. China is not known for transparency, making their national lending and aid practices opaque to the casual observer. This is compounded by the large disparity between China's public aid announcements and actual deeds. In Oceania, China is estimated to execute as little as 20% of the aid packages to which it commits.<sup>37</sup> Paradoxically, the obscurity of China's aid leads to intense interest in the subject, meaning that their activities in the developing world are actively studied, and data is readily available.

AidData.org publishes an impressively thorough database of China's worldwide financial activities. They include descriptions of projects, which Chinese agency provided funding, the degree of completion, and a range of statistical data.<sup>38</sup> Unfortunately, it only includes projects

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<sup>36</sup> Kaufmann, D., & Kraay, A. (2019). *Worldwide Governance Indicators (WGI)*. Natural Resource Governance Institute, Brookings Institution, and World Bank Development Research Group.

<sup>37</sup> Dayan, A., & Pryke, J. (2019, October 31). Chart of the week: Australian versus Chinese aid in the Pacific. *The Interpreter*.

<sup>38</sup> Dreher, A., Fuchs, A., Parks, B., Strange, A., & Tierney, M. (2017). *Aid, China, and Growth: Evidence from a New Global Development Finance Dataset*. Williamsburg, VA: AidData.

through 2014. More recent data is available from the Lowy Institute, an Australian think tank and one of the world's foremost authorities on the Pacific region. In addition to providing hard data on Chinese aid projects, the Lowy Pacific Aid Map is an oft-cited interactive tool for tracking aid projects in Oceania from all nations. The Lowy Institute is still compiling data for 2018, so 2017 is the last year with complete information.<sup>39</sup> Together, these sources identify Chinese investment trends and allow identification of the most impactful projects.

## **Method**

The assembled data was analyzed in three ways. First, general trends were identified in the governance data, defined as positive or negative changes in an index continuing for longer than three years. Significant short-term changes were also considered, defined as a one-year change of greater than 10% in one factor or 5% in multiple factors that did not return to the previous level in the following year. These trends were correlated with Chinese investments during the same period.

The second analysis was from the perspective of significant events. Historically large projects were identified, and the governance data was examined for the years following the project announcement or commencement to see if a changing trend or a significant short-term change could be identified. The same analysis was conducted when countries switched diplomatic relations between China and Taiwan.

Lastly, Chinese commitments and spending trends were examined to identify significant increases in the annual contributions to each country. Any change in total funding by more than 30% from the previous year, or by 50% within three years triggered a similar look at governance data for that period.

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<sup>39</sup> Lowy Institute. (2019). *Pacific Aid Map*.

The focus of these investigations was to look at changes in governance ratings, not the overall level of good governance. Most Pacific Island countries score below average in areas of regulatory quality and government effectiveness. Most score relatively high on political and civil freedoms. The purpose of this study is to try to identify whether aid funding is affecting the trajectory of these ratings.

## Analysis

### **Group 1 – Large PRC Aid Recipients**

The largest recipients of PRC aid and investment in Oceania are Samoa, Tonga, and Vanuatu. All three rank among the countries in the world most heavily indebted to China. China is also the single largest creditor in all three states, and in the case of Tonga it holds greater than half the national debt.<sup>40</sup> They are therefore the most likely to be affected by China's lending.



Samoa shows a slight downward trend in five of the six WGI indicators from 2003-2011, with a corresponding gentle rise from 2011 onward.<sup>41</sup> Freedom House civil liberties index also registered an upward trend beginning with the 2016 report. Although there was a slight decrease on the political rights measurement during that same time. Freedom House still rates Samoa as “Free”.<sup>42</sup>

The first non-disaster Chinese development loan to Samoa was for \$52 million to build government offices and a conference center announced in 2006 with construction beginning in 2010. Samoa received its first Chinese development grants the same year. By the end of 2017

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<sup>40</sup> Rajah, Dayant, & Pryke, 2019.

<sup>41</sup> Kaufmann & Kraay, 2019.

<sup>42</sup> Freedom House, 2020.

over \$231.3 million had been executed, including \$162.8 million in loans.<sup>43</sup> The most significant one-year increase in funding after 2010 was in 2015: a \$60 million loan for upgrades to the Faleolo International Airport, which is the largest single project to date. There was not an associated reduction in governance observed in the following years. Despite the considerable total funding, Samoa's governance indicators remained relatively steady throughout this time.

Samoa is currently undergoing a debate over a proposed constitutional amendment that would make changes to the judiciary. Critics say it will undermine rule of law by promoting the Land and Titles Court, which deals with cultural and chiefly issues, to the same level as the supreme court.<sup>44</sup> This does not appear to be related to any Chinese activities.



Tonga's governance factors are a jumble with no clear trends until 2006. That year saw riots in the capital, Nuku'alofa, over the new king's failure to increase direct representation in Parliament. The riots prompted the government to declare a state of emergency, but they agreed to fully free elections in 2008. After 2006, significant improvements were seen in governance. Several WGI factors and all of the World Bank CPIA factors showed significant improvements from 2006-2008, some improving by as much as 30%. Transparency International's CPI registered a 15% improvement in perceived corruption before tracking ceased in 2011. The most marked increase was in the Freedom House political rights rating which registered a 35% jump between 2010-2011, probably latent improvement from the 2008 elections. Since 2011 nearly all governance factors have shown a gradual upward trend.

The largest Chinese financial involvement in Tonga to date was a \$63.3 million loan to rebuild the Nuku'alofa business district after the riots. The loan was negotiated in 2006 for a 2%

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<sup>43</sup> Lowy Institute, 2019.; Dreher, Fuchs, Parks, Strange, & Tierney, 2017.

<sup>44</sup> Fiona, E. (2020, May 8). Samoa's constitutional crisis: Undermining rule of law. *The Interpreter*.

interest rate and 10 year maturity, but was renegotiated in 2010 to add a ten year grace period. In 2010 Tonga signed a loan with China for \$44.4 million dollars for a road improvement program. The remainder of Chinese aid to Tonga has been in the form of grants totaling \$52.2 million through 2017. The greatest one-year increase in funding was a 100% increase from 2015 to 2016.

Despite the relatively reasonable loan rates and two rounds of refinancing, Tonga is still having trouble repaying the loans. Publicly, the Tongan government praises Chinese assistance.<sup>45</sup> As discussed, governance increased during the period of these loans and grants.



Vanuatu governance ratings show major changes in 2003. Most governance indicators rose between 2003 and 2005, but the WGI voice and accountability rating and Freedom House political rights decreased. All factors remain fairly level until 2014 when several of the WGI indicators show a sharp reduction. These factors rebounded in 2017, along with Transparency International's CPI which had a drastic improvement from 2018 to 2019.

The 2014 dip in ratings coincides with the announcement of the single largest Chinese loan to date: \$86 million to develop a wharf in Luganville. The project was criticized when it was announced for lack of transparency and the way it had been negotiated outside of normal government channels. There were also concerns that it indicated Chinese military basing ambitions or that the deal might include an equity swap clause.<sup>46</sup> This deal could account for the reduction in perceived governance, particularly considering that construction began in 2015 around the time that Sri Lanka leased the Hambantota port facility to China. In 2018 the

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<sup>45</sup> Tongan Government 'Overwhelmed' by Assistance Provided by China. (2017, January 24). *Pacific Islands Report*.

<sup>46</sup> Bohane, B. (2018, June 13). South Pacific Nation Shrugs off Worries on China's Influence. *The New York Times*.

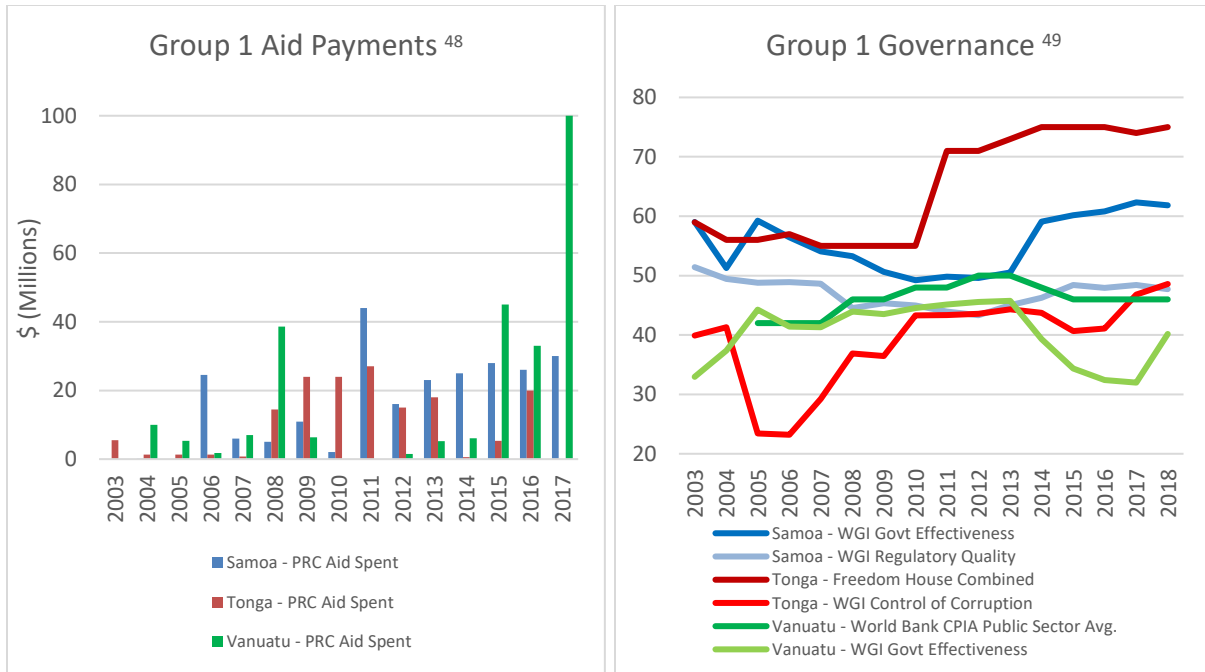
government of Vanuatu published the full agreement, showing that it was a relatively standard concessionary loan with a five-year grace period followed by 2.5% interest for 15 years.

Vanuatu is adamant that they are able to pay it off, and that the wharf was essential for cruise ships and commercial fishing vessels.<sup>47</sup>

Vanuatu has a long history of aid from China, receiving the first non-financial grants in 1985, the first monetary grant in 2007, and the first loan in 2008: \$28.8 million for government communications through Huawei. Vanuatu also provides China with close political support. They were the first government to recognize China's South China Sea claims. Total aid since 2007 equals \$274.5 million, with \$203.3 million in the form of loans. The highest single year of aid commitments was 2015 when the Luganville Wharf project was announced. 2017 saw the highest expenditures to date with China spending \$99.65 million in Vanuatu including \$57.5 million on the Luganville Wharf. Vanuatu was the biggest recipient of Chinese aid and loans in Oceania that year, and it was also the first year that China outspent Australia in Vanuatu.

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<sup>47</sup> Ibid.



The group one analysis yields some interesting results. For Samoa and Tonga there are no declines in good governance measures correlating to Chinese aid payments. Vanuatu shows the first instance where a large Chinese project corresponds with decreased good governance perceptions. The ratings rebounded after the Luganville wharf loan terms were published. This indicates that an individual project can have a greater effect on governance rankings than overall funding. The example of Vanuatu’s public pressure on the government to release the details and the effectiveness of riots in Tonga to spur legislative change also lend credence to Wesley-Smith’s assertion that the local politics of Pacific island states provides an effective unofficial accountability mechanism. Lastly, group one provides useful insights into the responsiveness of the different indices. The WGI ratings reacted promptly to both restoration of political rights in Tonga and to the Vanuatu wharf. Freedom House rankings, on the other hand, remained

<sup>48</sup> Aid data includes grants and concessional loans. Aid from 2011-2017 is taken from the Lowy Institute Pacific Aid Map. Aid from 2003-2010 is derived from AidData and distributed evenly over the active years of a project. Aid announcements and commitments are not represented.

<sup>49</sup> All governance data is adjusted to fit on a scale from 0 to 100. For the sake of clarity, only select factors are displayed; additional factors can be found in the appendices.

depressed for several years, only registering improvements in Tongan political rights in 2011, three years after the elections.

## **Group 2 – Some PRC Aid**

Fiji, Kiribati, and the Federated States of Micronesia (FSM) have varying relations with China. All have received some financial support in the form of development loans or grants. At the same time, China is neither the primary debt holder nor the primary donor to any of these countries. FSM has a very large aid relationship with the United States, and the other three nations receive most of their aid from Australia, with smaller amounts coming from New Zealand and the European Union, all of which have initiatives to promote good governance.<sup>50</sup>

China is a moderate trading partner with Fiji and Kiribati, consuming about 16% of exports from each. China is the main source of imports into FSM (38%) and is the destination for 17% of FSM exports.<sup>51</sup> Although trading relationships can provide opportunities for the larger partner to exercise economic leverage for political goals, trade does not promote opportunities for corruption the same way that poorly regulated aid can.<sup>52</sup> The impact of China's aid payments to these countries should therefore be smaller than those in group one.



Of the countries in Group 2, Fiji has the most active relationship with China.

China took advantage of Fiji's coup in 2006 and subsequent suspension from the Pacific Islands Forum (PIF) to increase relations.<sup>53</sup> Fiji also cooperates militarily with China, while still operating with Australia.

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<sup>50</sup> Lowy Institute, 2019.

<sup>51</sup> OEC. (2020). Retrieved from Observatory of Economic Complexity: <https://oec.world/en/>

<sup>52</sup> Collier, 2007.

<sup>53</sup> Wesley-Smith & Porter, Oceania Matters, 2010.



Fiji's governance rankings show clear trends, patently related to the coups in 2000 and 2006, the dissolution of the judiciary and the constitution in 2009, and the return to democracy in 2014. Fiji shows a downward trend in nearly all categories between 2000 and 2009 with some very drastic declines. After 2010 there is a steady upward trend in all factors. By 2018 most governance factors had returned to scores equal to those before the 2000 decline.

Chinese aid took a significant jump immediately after the 2006 coup in the form of a \$150 million loan, delivered in 2007. This was followed by \$70.9 million the following year as part of a joint venture. Chinese aid continued through the years after the coup including lending \$83 million for a power plant over 2009-2012.<sup>54</sup> China exceeded Australia's aid to Fiji during 2011-2015 as it delivered the largest individual projects in the last decade: Three loans totaling \$245.4 million for road upgrades.<sup>55</sup> China now holds approximately 10.6% of Fiji's national debt.<sup>56</sup>

Despite the considerable long-term and large individual projects contributed by China, Fiji's governance ratings do not deviate from the trend discussed above. An argument could be made that the \$150 million loan immediately after the coup prolonged the duration of the recovery, but that would require deeper research than can be covered in this paper. Fiji has demonstrated ongoing amenableness to Chinese policies by complaining to Nauru about their perceived disrespect to China at the Pacific Islands Forum, and by allowing Chinese officials to arrest 77 Chinese nationals on Fiji soil. At the same time, Fiji has proven to be adept at benefitting from the competition between aid donors. In 2018 they accepted a patrol boat from Australia and also a hydrographic survey vessel from China. They then allowed the two

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<sup>54</sup> Dreher, Fuchs, Parks, Strange, & Tierney, 2017.

<sup>55</sup> Lowy Institute, 2019.

<sup>56</sup> Mudaliar, C. (2018, October 4). Australia Outbids China to Fund Fiji Military Base. *The Interpreter*.

countries to bid on who would build their new Black Rock military training base before finally awarding the project to Australia.<sup>57</sup> Fiji provides one example of how a small nation can best profit from the current geopolitical rivalry.



Like Fiji, several Kiribati governance ratings trend downward until 2011, and then upward from that point on. This trend is much more gradual than Fiji, but several of the factors remain much lower than what is seen in other countries in the region, particularly regulatory quality. The rest of the data for Kiribati is somewhat inconsistent, bounding from year to year with no clear patterns. Kiribati being the most geographically dispersed nation in Oceania, it is possible that normal annual variations in survey methods yielded unusually varied results.

Kiribati has a complicated history with China. Neither the Lowy Institute nor AidData record any Chinese investment in Kiribati with the exception of a planned \$5.5 million sports complex project that was canceled in 2003. In 1997 the People's Liberation Army (PLA) opened a satellite tracking station on Tarawa Atoll. While it was in operation, Kiribati received \$250,000 in annual rent payments from China and unspecified additional aid.<sup>58</sup> Anecdotal evidence indicates that China provided aid for improvements to the international airport on Tarawa and furnished a ferry. There are also unproven allegations that China funded the re-election campaign of Kiribati leaders in 2002.<sup>59</sup> The satellite tracking station was shut down in 2003, and in the same year Kiribati switched diplomatic ties from the PRC to Taiwan. Between 2011 and 2017 Kiribati has received \$83 million in aid from Taiwan and \$205 million from

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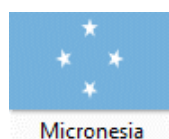
<sup>57</sup> Mudaliar, 2018.

<sup>58</sup> Fickling, D. (2003, December 01). Diplomacy for Sale. *The Guardian*.

<sup>59</sup> Henderson & Reilly, 2003.

Australia. Australia outspent Taiwan every year. The single largest project in Kiribati was a \$33.1 million Japanese grant to expand Betio port between 2011 and 2014.<sup>60</sup>

Governance trends shifted upward soon after Kiribati switched diplomatic relations from the PRC to Taiwan. The trend is gradual and is not uniform across all measures. Kiribati suddenly decided to switch diplomatic relations back to the PRC in 2019 without explanation. In 2003 they cited impressions of generally better economic status among nations who recognize Taiwan. The fact that China increased aid payments since 2006 probably influenced the decision to switch back. It remains to be seen whether their governance will continue its upward trend.



Federated States of Micronesia (FSM) is the only Compact of Free Association (COFA) state that also receives noticeable support from China. This makes it an interesting country in which to study regional competition between the two powers.

FSM governance data shows a marked rise in all six WGI factors and the Freedom House civil liberties score from 2002-2005. After 2005 three of the WGI factors return to their previous levels over 5-7 years. The rest of the indices stay steady for the duration of the available data, with the exception of the WGI control of corruption index, which shows a 20% increase in 2014.

The U.S. is by far the largest donor to FSM, with COFA grant commitments of \$1.8 billion through 2004-2023.<sup>61</sup> FSM is the biggest recipient of U.S. aid in Oceania, totaling \$598 million spent from 2011-2017. China significantly increased funding in 2014 beginning with the approval of a \$12.7 million grant to build the Okat bridge. Chinese aid continued at increased levels through the available data adding up to a total of \$61 million from 2011-2018. All

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<sup>60</sup> Lowy Institute, 2019.

<sup>61</sup> Government Accountability Office (GAO). (May 2018). *Compacts of Free Association: Actions Needed to Prepare for the Transition of Micronesia and the Marshall Islands to Trust Fund Incomes.*

Chinese aid to FSM is in the form of grants, including an agreement to provide a \$5 million grant every year from 2017-2025 which is the largest single Chinese contribution to date.<sup>62</sup>

There is no apparent correlation between Chinese aid and the bubble in governance data from 2002-2013. The sudden rise in the WGI control of corruption score, however, does correlate with FSM Congressional debates regarding approval of the Okat bridge project. FSM law requires Congressional approval of all foreign aid (except aid from the U.S. as part of the COFA).<sup>63</sup> The Okat bridge project was negotiated in 2011, but not approved until 2014 after public debates in Congress. It is possible that a public demonstration of transparency increased perceptions that FSM was giving Chinese projects their due scrutiny. The idea that Chinese aid could provide an opportunity for nations to demonstrate their administrative processes and adherence to rule of law, and thereby increase their attractiveness to investors, is an interesting corollary.

PRC's exclusive use of grants in FSM is unparalleled. Some critics believe that this is an indication that China wants to influence the renegotiation of the COFA agreement in 2023 to deny the U.S. access to the region.<sup>64</sup> The President of FSM, Peter Christian, consistently contradicts such concerns by pointing out that the long-standing alliance with the U.S. is much stronger than Chinese financial ties, saying, "I tell people all the time, that my relationship with China can never be the same as my relationship with the United States."<sup>65</sup>

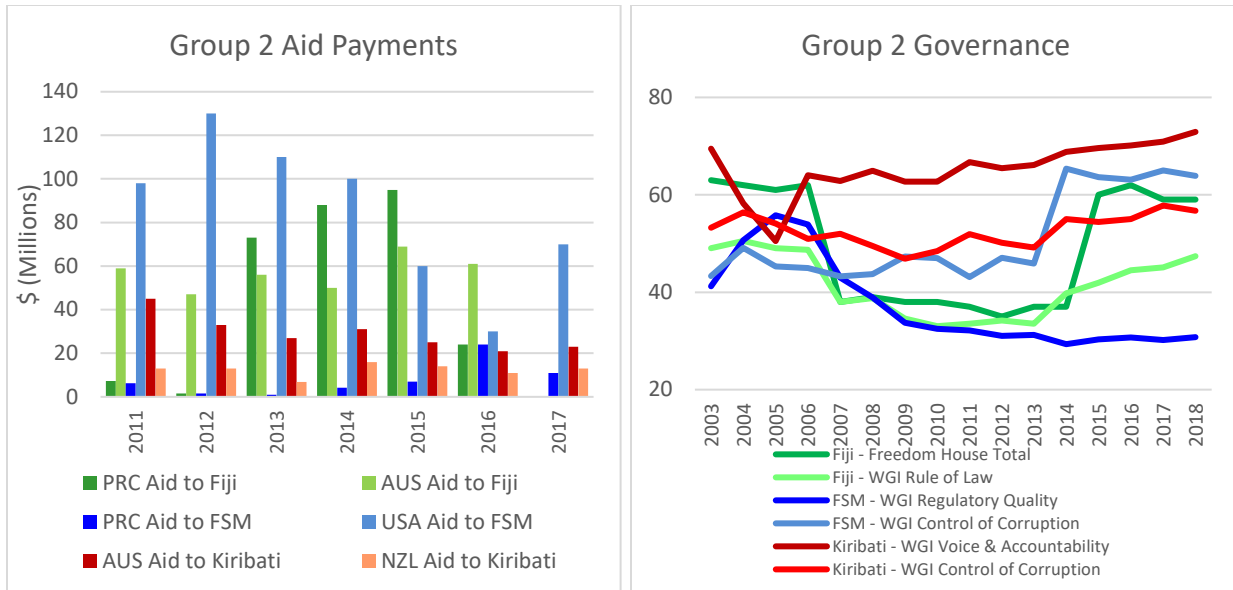
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<sup>62</sup> Lowy Institute, 2019.

<sup>63</sup> Dreher, Fuchs, Parks, Strange, & Tierney, 2017.; Federated States of Micronesia. (n.d.). Section 210, Title 55, Foreign Assistance Fund. *FSM Code*.

<sup>64</sup> Parker & Chefitz, 2018.

<sup>65</sup> Jaynes, B. (2017, April 5). FSM President Opens Up About Official Visit to China. *The Kaselehlie Press*.



Group 2 provides interesting fodder for discussion and further research, but does not lend any concrete evidence that Chinese aid increased corruption. Although all three experienced downward trends at some point, the presence of traditional aid donors such as Australia and the U.S. in the marketplace make it impossible for these countries to abandon good governance principles, even if they were tempted to do so. Unless China was ready to pick up the entire aid tab, the recipient country would lose considerable funding. In the case of FSM, the long relationship with the U.S. is evident in their legal controls and transparency which make them more resistant to corruption. Their regulatory structure also mandates scrutiny of loan and grant terms so that FSM is more capable of avoiding poor quality projects and financing, and is certainly a factor in why FSM has only accepted grants from China. Implementing such legal checks, however, inhibits one desirable aspect of Chinese lending: that it is more rapid and responsive.

### Group 3 – No Financial Assistance from China

The Solomon Islands, Tuvalu, and the Republic of the Marshall Islands (RMI) all maintained formal relations with Taiwan during the duration of this study, and therefore received no aid from China. According to the premise that Chinese aid and financing contribute to corruption, these nations should be free to follow their own policies as envisioned by the U.S. Free and Open Pacific strategy. They will act as a control group to see how governance responds in the absence of pressure from the PRC.



Solomon Islands is somewhat unique among the nations being studied. It is larger than the others, is located closer to the large nations of Australia and Indonesia, and is the only nation with enough natural resources to sustain an economy. Solomon Islands is heavily dependent on unregulated logging, which accounts for over 70% of its exports. China makes up two thirds of its export market.<sup>66</sup> Like the other Melanesian nations (Papua New Guinea, Fiji, and Vanuatu), the Solomon Islands have a history of violence. Between 1999 and 2003 tribal and ethnic violence consumed parts of the country, resulting in tens of thousands of deaths and injuries until an Australian-led peacekeeping force was brought in and the government negotiated with the primary warlords. In 2006 violence erupted again, this time targeting Chinese immigrants, who are often portrayed as criminals and undesirables in the islands.<sup>67</sup>

Governance scores in Solomon Islands plummeted uniformly during the 1999-2003 conflict. By 2005 they rebounded to their (admittedly low) pre-conflict levels. Most rankings

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<sup>66</sup> OEC, 2020.

<sup>67</sup> Kabutaulaka, T. T. (2010). Milking the Dragon in Solomon Islands. In T. Wesley-Smith, & E. A. Porter (Eds.), *China in Oceania: Reshaping the Pacific?* (pp. 131-150). New York: Berghahn Books.

kept steady until 2014 when an upward trend began in six different factors. Most significantly, the normally sluggish Freedom House political rights score rose to historic heights, earning the country a promotion from “partially free” to “free” for the first time in 2017.

Solomon Islands was an early target for Taiwanese “dollar diplomacy”. Recently, however, Taiwan’s funding has decreased significantly. Australia remains the dominant donor by far, contributing an impressive \$1.38 billion between 2011 and 2017. Solomon Islands is the second largest recipient of Australian aid, behind PNG. Taiwan provided \$108 million during the same period. The four largest projects were all Australian multi-year capacity development programs. Taiwan’s largest contribution was an \$87.8 million grant payable over 2011-2018 for constituency development,<sup>68</sup> which includes providing offices, supplies, and training to government workers.<sup>69</sup> That was the only Taiwanese grant over \$5 million. The largest short-term infrastructure project was a \$20.4 million Japanese grant for improving port facilities in 2015-2016.<sup>70</sup> There are no obvious changes in governance tied directly to these individual projects.

There are allegations that Taiwan financed cronyism during its years of interaction with Solomon Islands by funding pet projects in order to buy political recognition.<sup>71</sup> Even so, after long and contentious public debate, Solomon Islands cut off diplomatic relations with Taiwan in October 2019. China offered tempting incentives including reopening a defunct gold mine, and offering personal payments of \$242,000 to each member of parliament, which they have so far failed to pay.<sup>72</sup> Two days after the switch of diplomatic relations, a deal was announced for

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<sup>68</sup> Lowy Institute, 2019.

<sup>69</sup> Solomon Islands Ministry of Finance and Treasury. (2018). *Solomon Islands Budget*.

<sup>70</sup> Lowy Institute, 2019.

<sup>71</sup> Kabutaulaka, 2010.

<sup>72</sup> Why politics in the south Pacific are so precarious. (2019, November 7). *The Economist*.

China to lease the entire island of Tulagi for 75 years. This was completed in a private deal with a Solomon political leader, and without notifying the inhabitants of Tulagi.<sup>73</sup>



Tuvalu is one of the staunchest allies of Taiwan in the Pacific. Although they are one of the countries most at risk by climate change, they refused Chinese offers to raise the elevation of several islands in favor of continuing relations with Taiwan.<sup>74</sup> A population of less than 12,000 makes their refusal to bow to Chinese pressure all the more impressive. Tuvalu is frequently impacted by extreme weather, including a tropical cyclone in 2015 that prompted a state of emergency declaration and a disaster response from New Zealand.

Tuvalu's governance scores declined sharply from 2000 to 2002 before rebounding just as rapidly in the next two years. This anomaly coincides with the first scores in a few categories of the WGI and may be in error. Scores steadily declined from 2004 to 2013 before beginning an upward trend. Most scores plateaued around 2015, including the World Bank CPIA ratings, which only began in 2012.

Australia is the largest donor to Tuvalu, contributing \$68 million between 2011 and 2017, although New Zealand outspent Australia in 2015. The single largest aid payment in Tuvalu was a \$19 million grant from the World Bank for aviation improvements between 2011 and 2019. New Zealand provided a \$14.2 million grant between 2014 and 2017 for renewable energy, and Australia granted \$12.5 million over 2011-2018 for good governance and economic growth. The two largest single-year payments were from Japan: \$9.6 million in 2011 for radio broadcasting networks, and \$9.4 million for a passenger vessel in 2015.<sup>75</sup>

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<sup>73</sup> Cave, D. (2019, October 16). China is leasing an entire Pacific island. Its residents are shocked. *The New York Times*.

<sup>74</sup> Lee, 2019.

<sup>75</sup> Lowy Institute, 2019.



The very small population of Tuvalu is an important factor. A small population can more easily fall victim to patronage and other forms of corruption. At the same time, the influence of any aid can have outsized effects. The consistency of Australian aid over the past decade should theoretically be a stabilizing force to put the country back on an upward trend in the future.



The Republic of the Marshall Islands (RMI) has a Compact of Free Association (COFA) with the U.S. As such it provides a point of comparison with FSM, which collects similar U.S. grants, but also receives Chinese aid. RMI is the world's third largest destination for ship registrations, after Panama and Liberia, which represent a significant portion of their economy.<sup>76</sup> They also have ties with the U.S. military, which operates a radar station on Kwajalein Atoll used to collect telemetry data from Hawaii missile tests. The relationship with the U.S. military is somewhat tainted by the history of nuclear tests on Bikini and Enewetok Atolls, and dissatisfaction with related cleanup efforts.<sup>77</sup> Like other Pacific island nations, RMI is at high risk for climate change and experiences frequent flooding.

Marshall Islands' governance data has trended downward since implementation in 2000. The WGI government effectiveness, regulatory quality, and political stability indices all demonstrate gradual declines. The WGI control of corruption index, however, gradually rises over the same period. There are no significant spikes in the data, and the World Bank and Freedom House scores remain level for the duration.

The U.S. is the primary aid donor to the Marshall Islands. The COFA agreement requires the U.S. to provide \$1.8 billion in development assistance, intended to increase self-sufficiency,

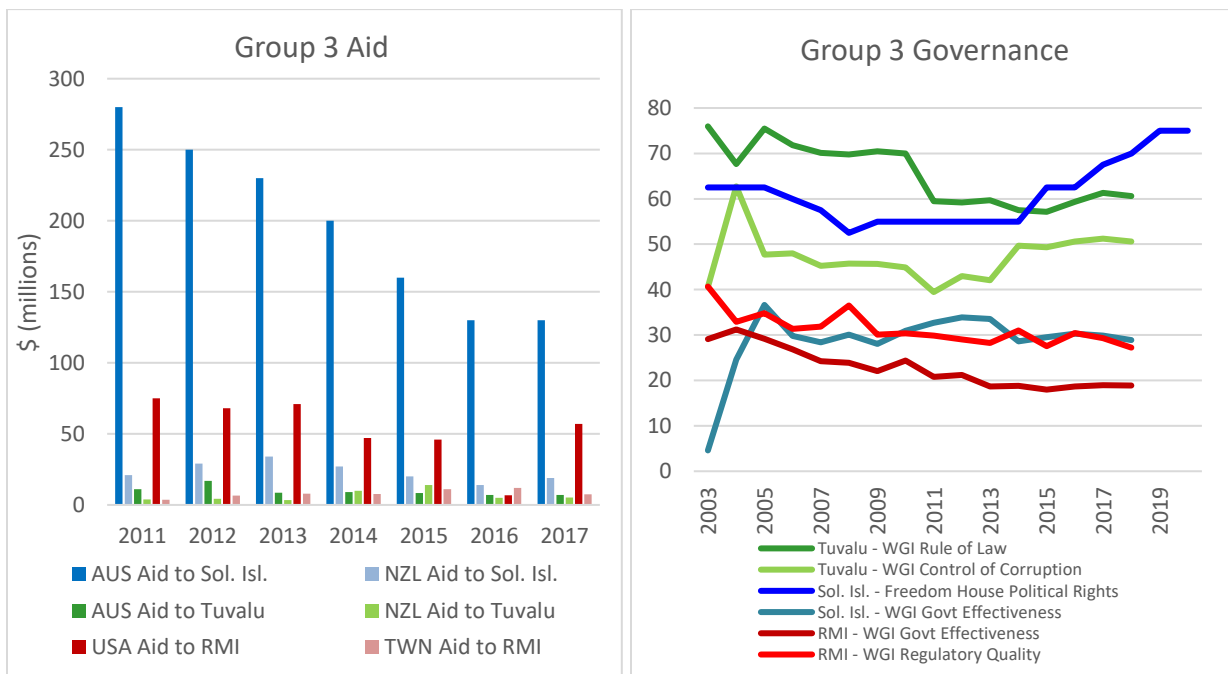
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<sup>76</sup> World Maritime News. (2019, January 29). Liberia Confirmed as Second-Largest Ship Registry in the World. *Offshore Energy*.

<sup>77</sup> Rust, S. (2019, November 10). How the U.S. betrayed the Marshall Islands, kindling the next nuclear disaster. *Los Angeles Times*.

between 2004 and 2023.<sup>78</sup> From 2011-2017 the U.S. contributed \$364 million to the Marshall Islands, including \$29 million annually for leasing Kwajalein Atoll. The next highest donors are Taiwan, Japan, and Australia who contributed \$56.4 million, \$47.3 million, and \$33.3 million respectively for the period 2011-2017. The single largest project not related to COFA payments was a grant from Japan for a \$13.6 million over two years to improve shipping services, completed in 2014. Taiwan’s single largest contribution was an \$8.1 million grant for outer islands economic development, payable over six years.<sup>79</sup> There were no identifiable changes in governance correlating to any large projects.

The Marshall Islands has experienced the steady decline of several governance factors despite the lack of Chinese involvement, and in the face of huge U.S. grants and concerted efforts to improve government capacity. Their status not only calls into question the impact of Chinese aid, but also the efficacy of U.S. good governance efforts.



<sup>78</sup> Government Accountability Office (GAO), May 2018.

<sup>79</sup> Lowy Institute, 2019.

Group three was a control group to demonstrate the potential for nations to thrive if not exposed to China's influences. Instead their performance was lackluster despite receiving some of the largest U.S. and Australian aid packages. While this does not disprove that aid from China can have a negative effect on governance, it does demonstrate that American and Australian aid are not effective at preventing poor governance.

### **Conclusion**

Good governance matters, particularly in countries with fewer economic prospects such as Oceania. In the extreme isolation of the Pacific, it is difficult for businesses or individuals to independently forge connections to a large market or the global economy. For that reason, the more isolated a country is and the fewer opportunities that exist, the more people tend to be reliant on government services. If those services are corrupt or inefficient, the entire society suffers.<sup>80</sup>

Good governance in Oceania matters to the United States as well, not only because it is listed as an essential element and line of effort for the Free and Open Indo-Pacific strategy. Although Oceania is far from Washington, the U.S. is still a Pacific nation with considerable interests in the region and numerous territories and possessions. Having corrupt neighbors would limit the ability to successfully pursue policy in the region.

This study examined whether aid payments from China have a negative effect on good governance, as commonly assumed. This is logical at first glance for a few reasons. First of all, one of China's main goals in the developing world is resource extraction, which as an industry is shown to directly contribute to corruption by increasing income inequality and capital flight.<sup>81</sup>

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<sup>80</sup> Collier, 2007.

<sup>81</sup> Ibid.

Secondly, the fact that China does not attach governance conditions to aid, as most western donors do, means that countries receiving Chinese aid have no requirement to reform. This effect was seen in the 1990's in Zimbabwe when Robert Mugabe was able to avoid a financial crisis and stay in power longer using Chinese loans. The most aggressive proponents of this theory propose for western lenders to abandon good governance goals because adherence to them only gives China a larger market share in the developing world.<sup>82</sup> This theory is false, at least in Oceania, because the appetite for aid is not yet satiated, and China is not ready to assume the full burden of aid that the Pacific islands need.

This study did reveal a few instances where Chinese aid payments correlated with decreased governance ratings. Immediately following the 2015 agreement for an \$80 million loan to build a wharf in Luganville, Vanuatu, that country's governance ratings declined. Locals suspected that the deal had unfavorable repayment terms and possibly an equity-swap clause. Once the details were released, however, Vanuatu's ratings rebounded. Similarly, several of Kiribati's ratings, including Transparency International CPI and World Bank public sector scores improved after Kiribati switched diplomatic relations to Taiwan in 2003. Fiji's 2006 coup government was also able to consolidate power due to a \$150 million grant from China. Lastly, the events surrounding the arrangement for China to lease the island of Tulagi, without public debate or notification, is expected to cause a decline in perceptions of good governance in the coming years.

Those are the only instances where declines in governance could be correlated to Chinese aid projects, however. With over \$1.1 billion spent on aid in Oceania between 2011-2017 (excluding Papua New Guinea), the results should have been more drastic. In fact, there are

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<sup>82</sup> Collier, 2007.

several instances when governance rose in the midst of Chinese contributions. Samoa and Tonga, two of the largest recipients of Chinese aid, both have upward trends in governance since 2012 and 2006, respectively. Even Fiji had an observable upward trend in governance beginning in 2011, three years before the return to democracy and during ongoing large Chinese aid programs. Chinese aid to Fiji increased every year from 2012-2015, as governance ratings continued to rise.

The most compelling evidence that aid from PRC does not equate to poor governance comes from comparing the Marshall Islands and FSM. Both are COFA states that receive equal assistance from the U.S., but FSM also receives aid from China. Between the two, FSM has more positive trends, whereas the Marshall Islands shows a slow but steady decline. FSM's detailed and transparent review of the China-funded Okate bridge project definitively demonstrated that their processes were not tainted by years of Chinese aid or the temptation of a large and popular project.

Taken together, the conclusion must be that Chinese aid does not automatically lead to corruption or other reductions in governance. China will still use economic leverage to achieve national objectives, but there is no evidence to indicate that they are as subversive as has been alleged. The idea that countries are insulated from negative effects of Chinese financing if they are receiving larger levels of aid from U.S. or Australia is disproven by the Group 3 countries, who were perfectly capable of declines in governance, and whose overall ratings remain comparable to the rest of the region.

An additional conclusion is that quality of governance is self-reinforcing. Countries with better regulatory oversight are able to process and oversee aid adequately to prevent the growth of corruption. Small nations often have difficulty with the administrative requirements of large

aid packages,<sup>83</sup> but FSM proved it is possible. They also have expressed an understanding that Chinese contractors need local oversight to ensure quality construction.<sup>84</sup> On the other hand, poorly governed countries, such as Fiji immediately following the 2006 coup, are able to resist reform for a time with the help of no-strings-attached aid from China. They cannot resist forever, however, unless China is willing to take on their entire aid budget.

Theories of the proper role of the state in regulating the market can help explain the conclusion that governance is self-reinforcing. In studies, autocratic bureaucracies are demonstrated to have the best economic performance in the developing world. Autocracies outperform democracies due to the ability to make rapid decisions and stick to an economic plan long enough to yield results. Bureaucracy is especially important in an autocracy in order to prevent cronyism and other forms of corruption in the distribution of the aid. This study did not include considerations of the various types of government in Oceania, but the country with the longest consistent upward trend in governance is Tonga, which is a constitutional monarchy.

The nature of life on a small island may also have protected them from outside influences, both positive and negative. Oceania mostly ranks high on the Freedom House rankings, indicating that there is a free flow of information and good individual liberties. That fact, combined with the small size of most settlements makes corrupt practices more difficult to hide, and allows an informal channel for grievances that are not captured in the official rankings.<sup>85</sup>

Since China does not appear to be contributing significantly to corruption in Oceania, the U.S. should not attempt to prevent their aid activities. That is not to say that America should not

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<sup>83</sup> Collier, 2007.

<sup>84</sup> Jaynes, 2017.; Schleich, 2018.

<sup>85</sup> Wesley-Smith, China's Pacific Engagement, 2010.

continue to compete. Competition can benefit the Pacific islands by allowing them the opportunity to gain more favorable deals. It is difficult for small nations with small economies to form an effective economic bloc,<sup>86</sup> so competition is one way that they can still achieve their goals.

On the other hand, U.S. rhetoric that poses economic competition in the Pacific as a zero-sum game is not constructive. For China, such verbiage in U.S. national policy documents play into their fears of strategic encirclement. For the Pacific island nations, it is insulting to be told that they are unable to determine their own best policies.<sup>87</sup> The sovereign nations of the developing world, including Oceania, have quickly learned the pitfalls of Chinese investment and will either protect themselves, or live with the consequences. The U.S. should continue to promote good governance while demonstrating the utility of those principles to islanders. Providing training on regulation and oversight, for instance, helps islands get the most from Chinese infrastructure projects, and would therefore not appear to be cultural interference. Ultimately, aid activities from China and the United States address different needs and are not mutually exclusive.

There is no evidence that any U.S. allies in Oceania intend to abandon America for closer ties with China, nor is there any evidence that China would provide more aid to such a country. The world of aid does not appear to conform to the hegemonic transition theory where a growth in Chinese capability threatens America's Pacific sphere of influence.<sup>88</sup> Instead, countries will continue to accept multiple partners, meaning that there is no threat of America and her partners losing all influence in the region as long as they continue to participate.

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<sup>86</sup> Collier, 2007.

<sup>87</sup> Jaynes, 2017.

<sup>88</sup> Levy, J. S., & Thompson, W. R. (2010). *Causes of War*. Oxford: Wiley-Blackwell.

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**Appendix A – Governance Indices by Country**

# Fiji



Fiji has a strong and long-lasting economic and military relationship with China. That has not prevented them from maintaining relations with Australia at the same time.

## Significant events:

2000 – Coup

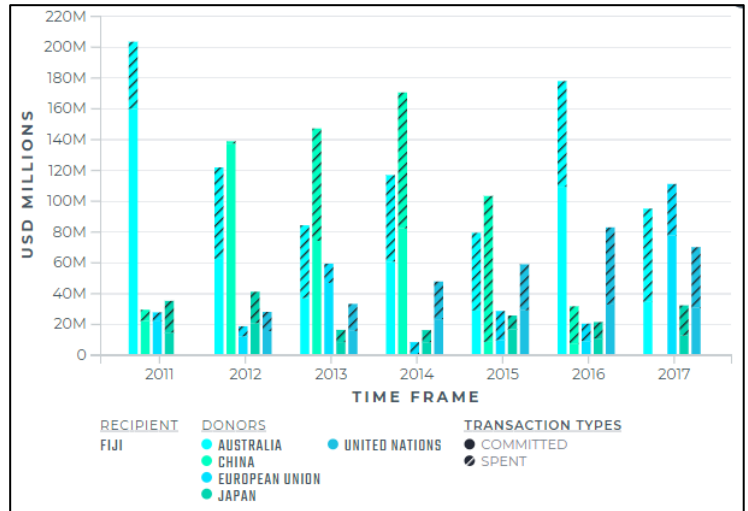
2006 – Coup by Commodore Bainamarama.

2007 – \$150 mil PRC budgetary loan

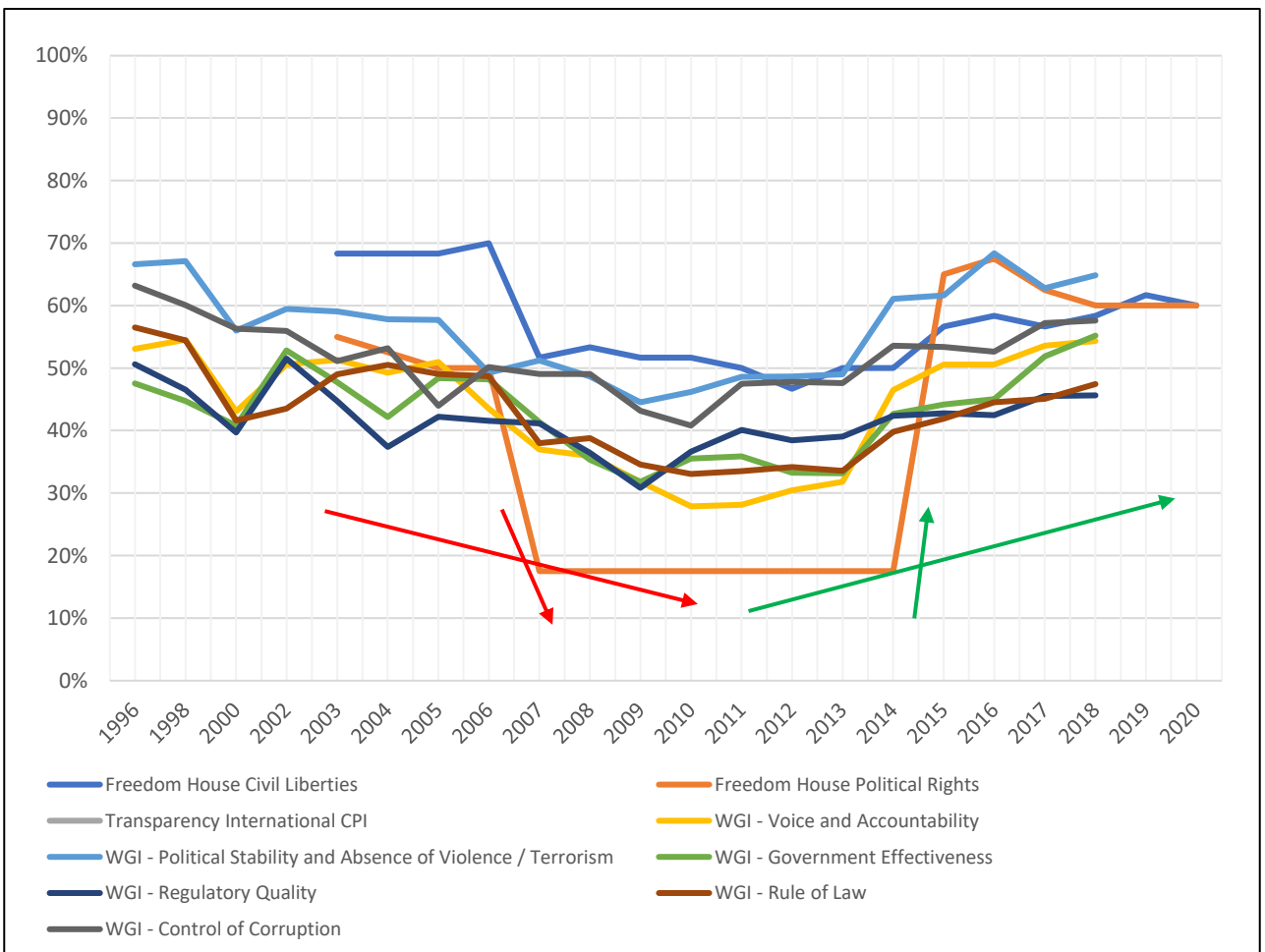
2008 – \$83 mil PRC loan for power plant (paid through 2012)

2011 - \$245 mil PRC loan for road improvements (paid through 2015)

2014 – Return to democracy



Source: Lowy Pacific Aid Map ©2019



# Kiribati

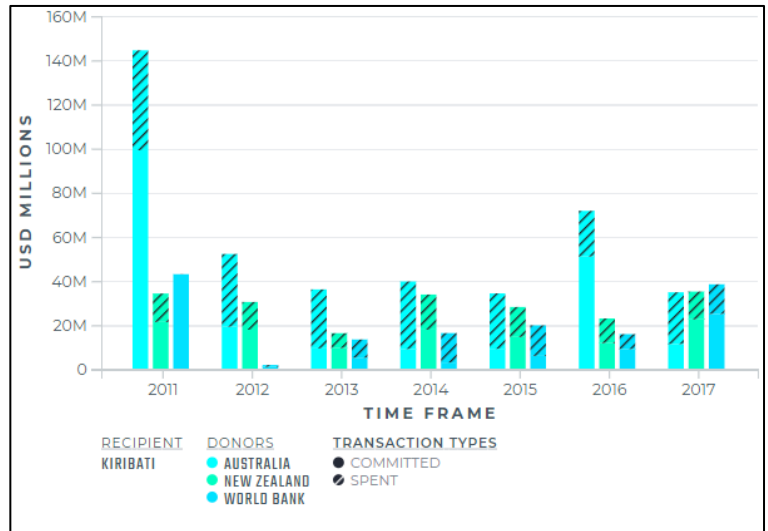


China has invested very little in Kiribati. Kiribati switched diplomatic relations to Taiwan in 2003, before PRC became more active in aid donations.

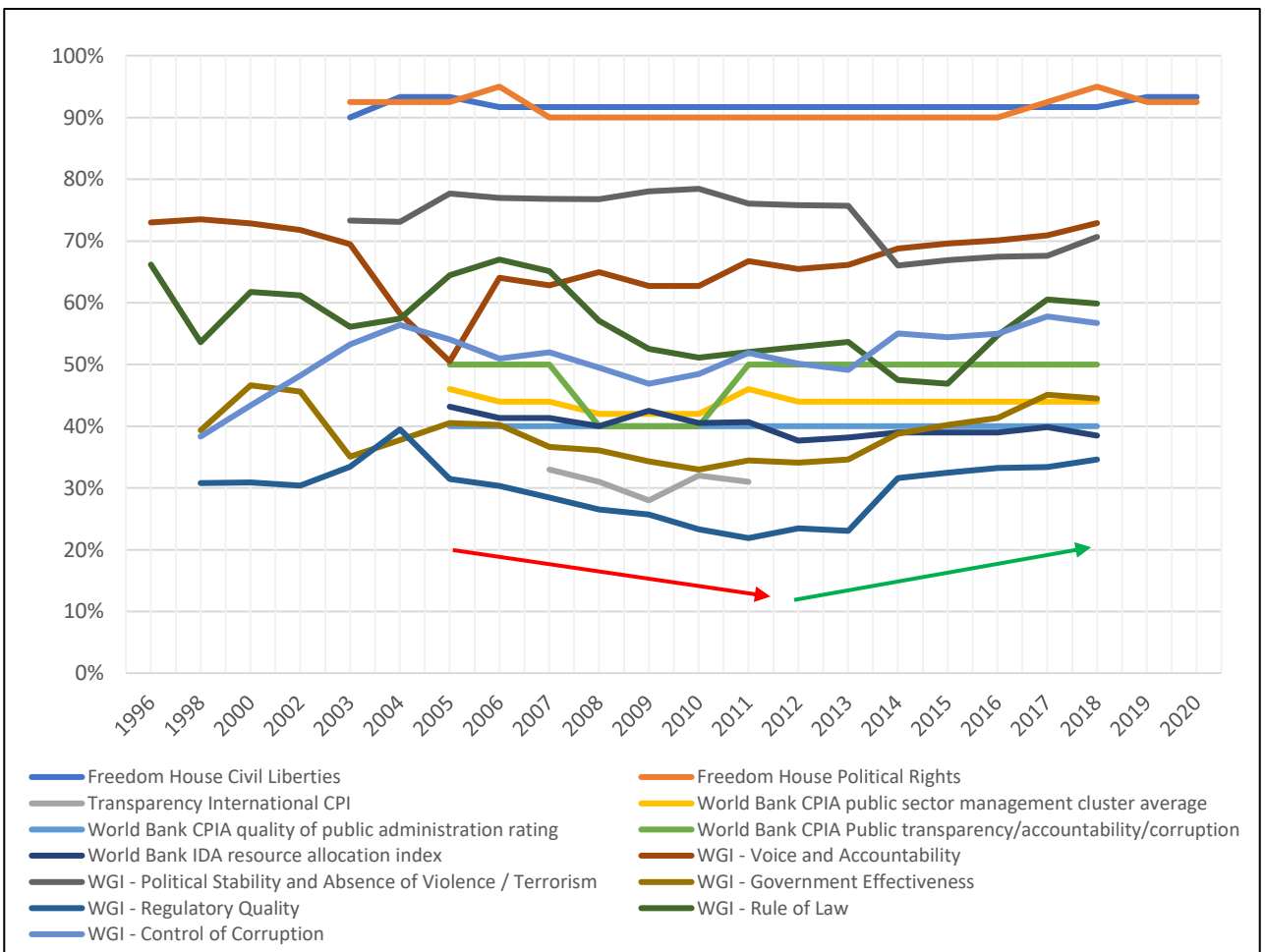
## Significant Events

2003 – Kiribati established diplomatic relations with Taiwan; PLA station closed

2019 – Kiribati broke off relations with Taiwan, re-established relations with PRC



Source: Lowy Pacific Aid Map ©2019

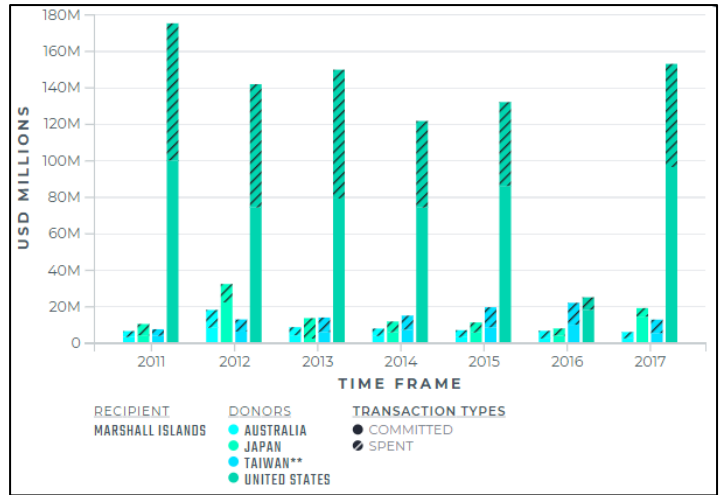




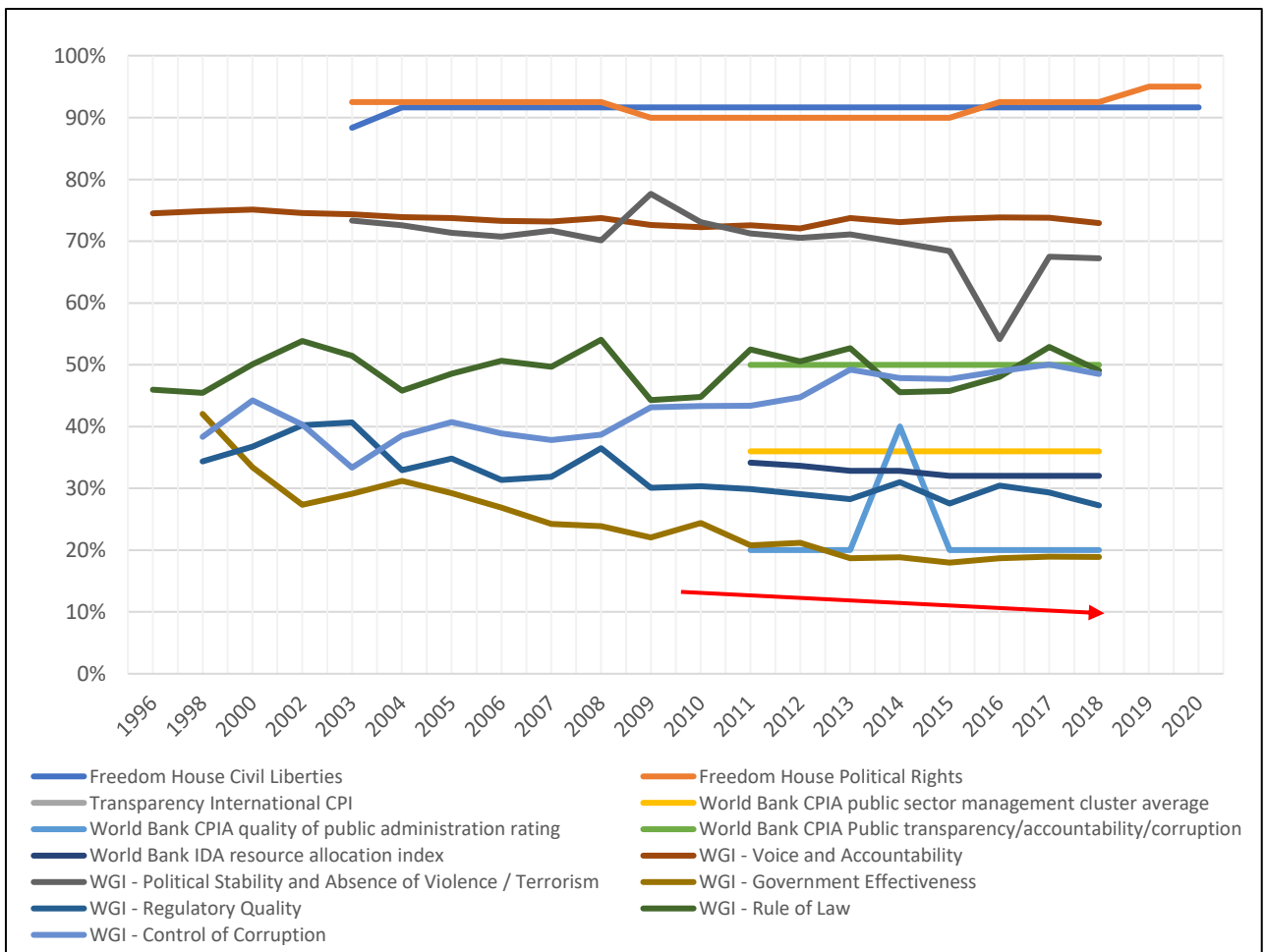
# Marshall Islands, Republic of the (RMI)

RMI does not recognize the PRC, preferring to maintain relations with Taiwan. It is also in a Compact of Free Association with the US, who is its biggest aid donor.

Aid is delivered consistently, with no major events. USA contributes more than all other donors combined; between \$45-\$75 mil per year.



Source: Lowy Pacific Aid Map ©2019





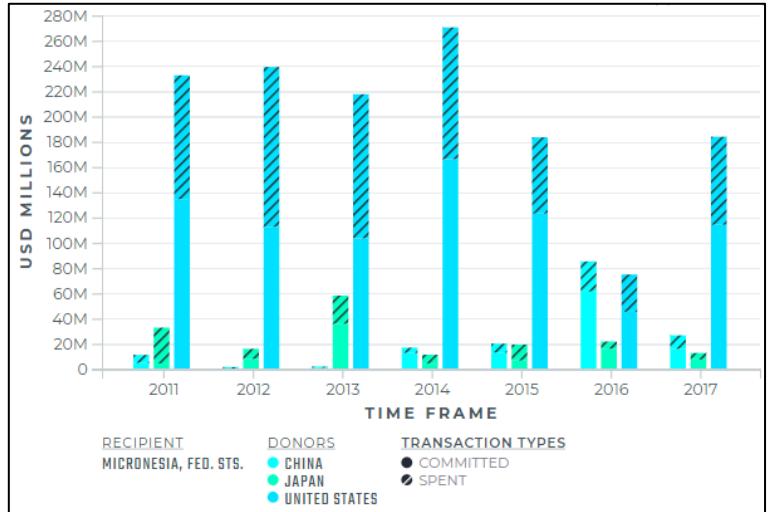
# Micronesia, Federated States of (FSM)

USA is the largest donor to FSM, which is the largest recipient of US aid in Oceania. China provides grants, and no loans, to FSM.

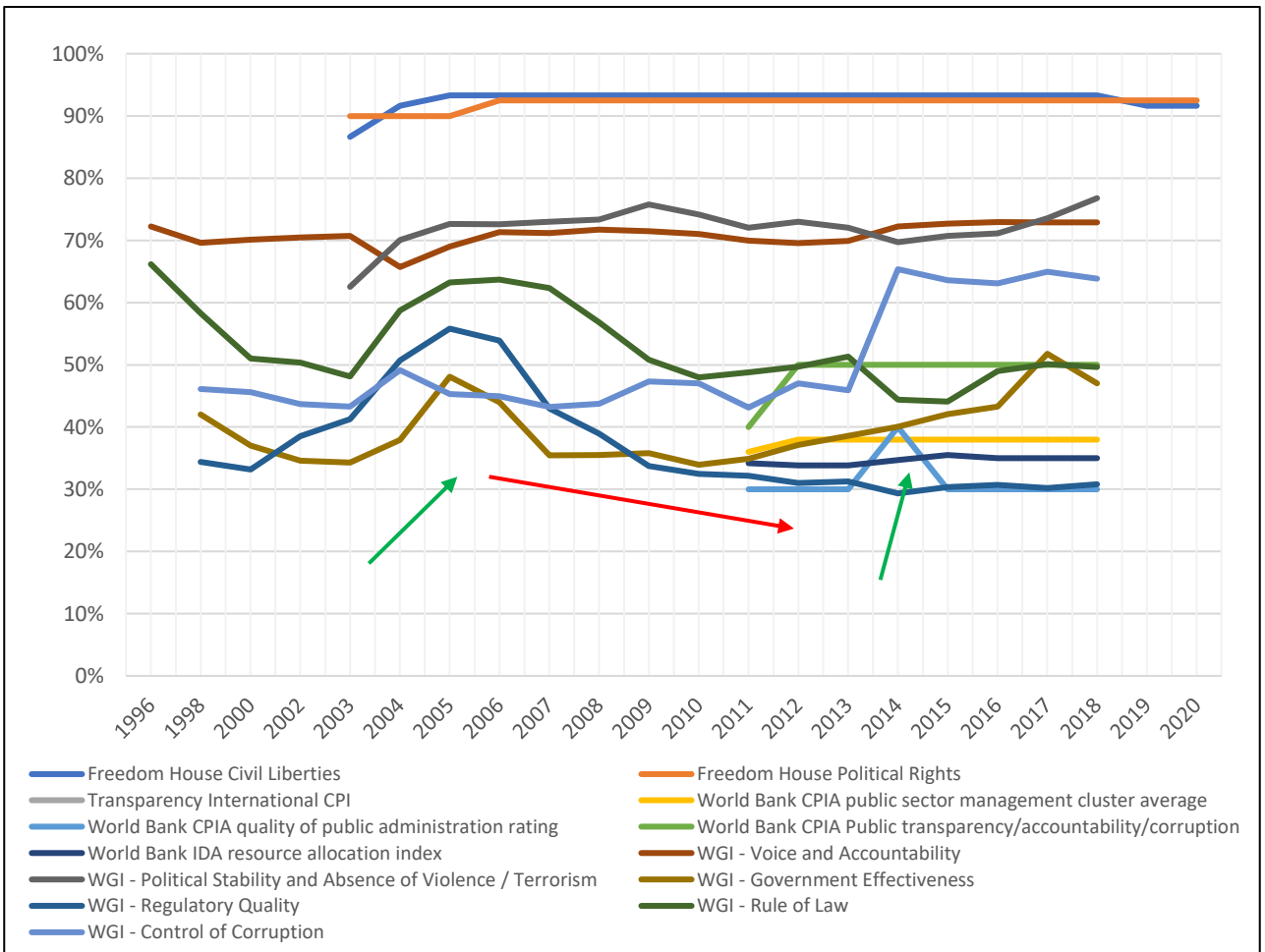
## Significant Events

2011 - \$12.7 mil PRC grant for Okat Bridge

2014 - Okat bridge project approved



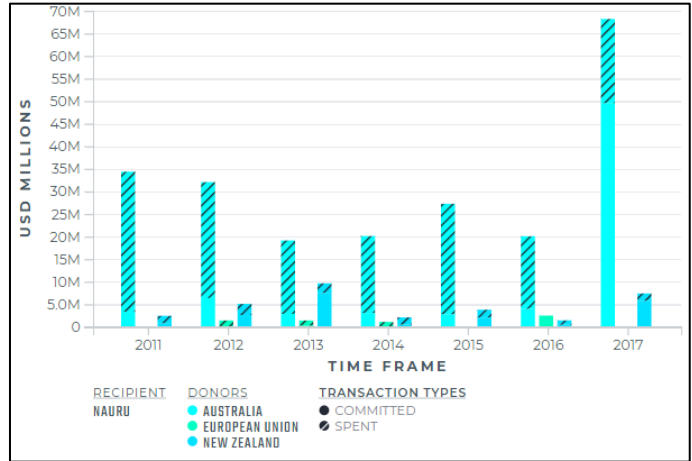
Source: Lowy Pacific Aid Map ©2019



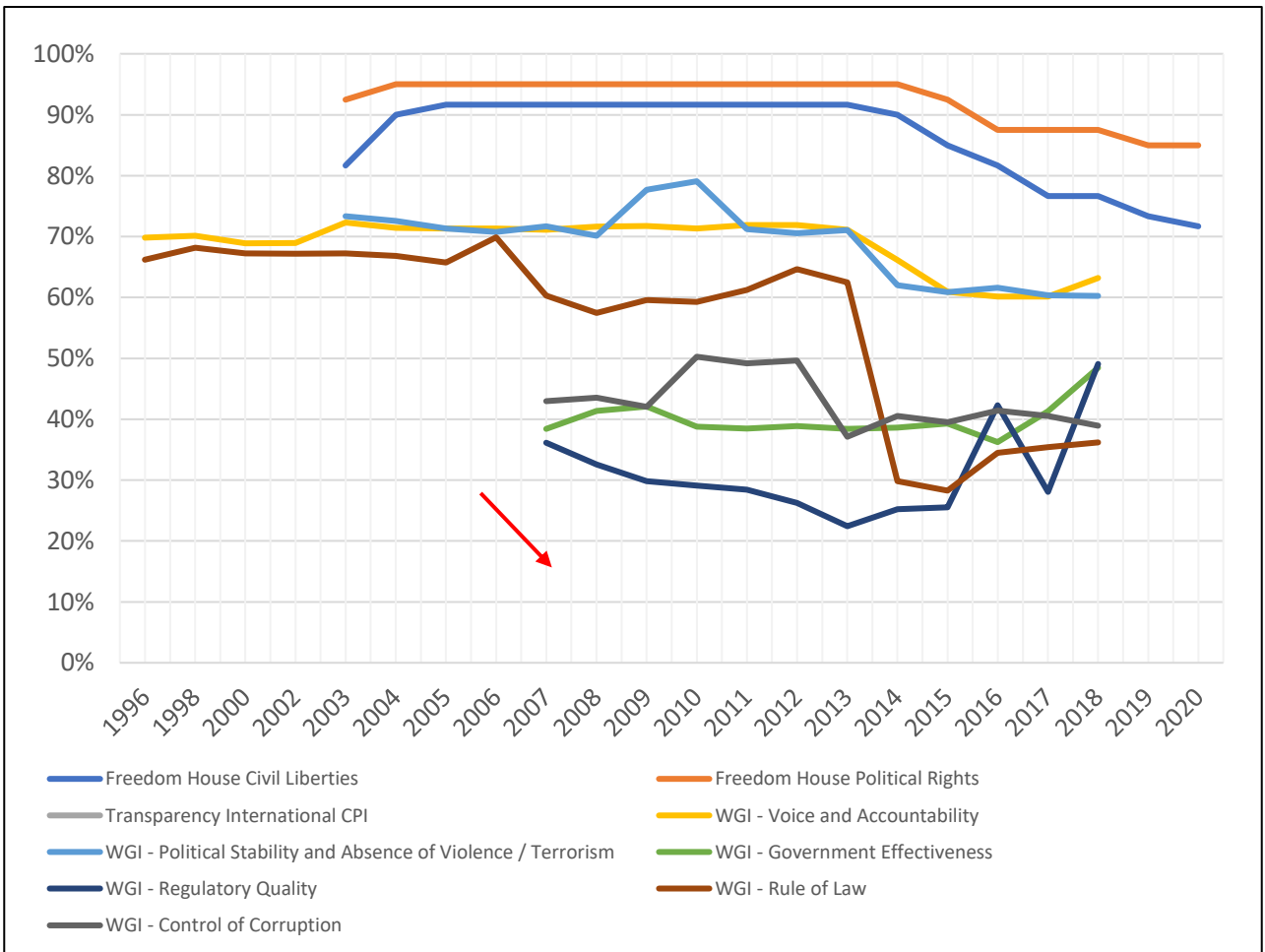
# Nauru



Nauru was not included in this study due to sparse data.



Source: Lowy Pacific Aid Map ©2019



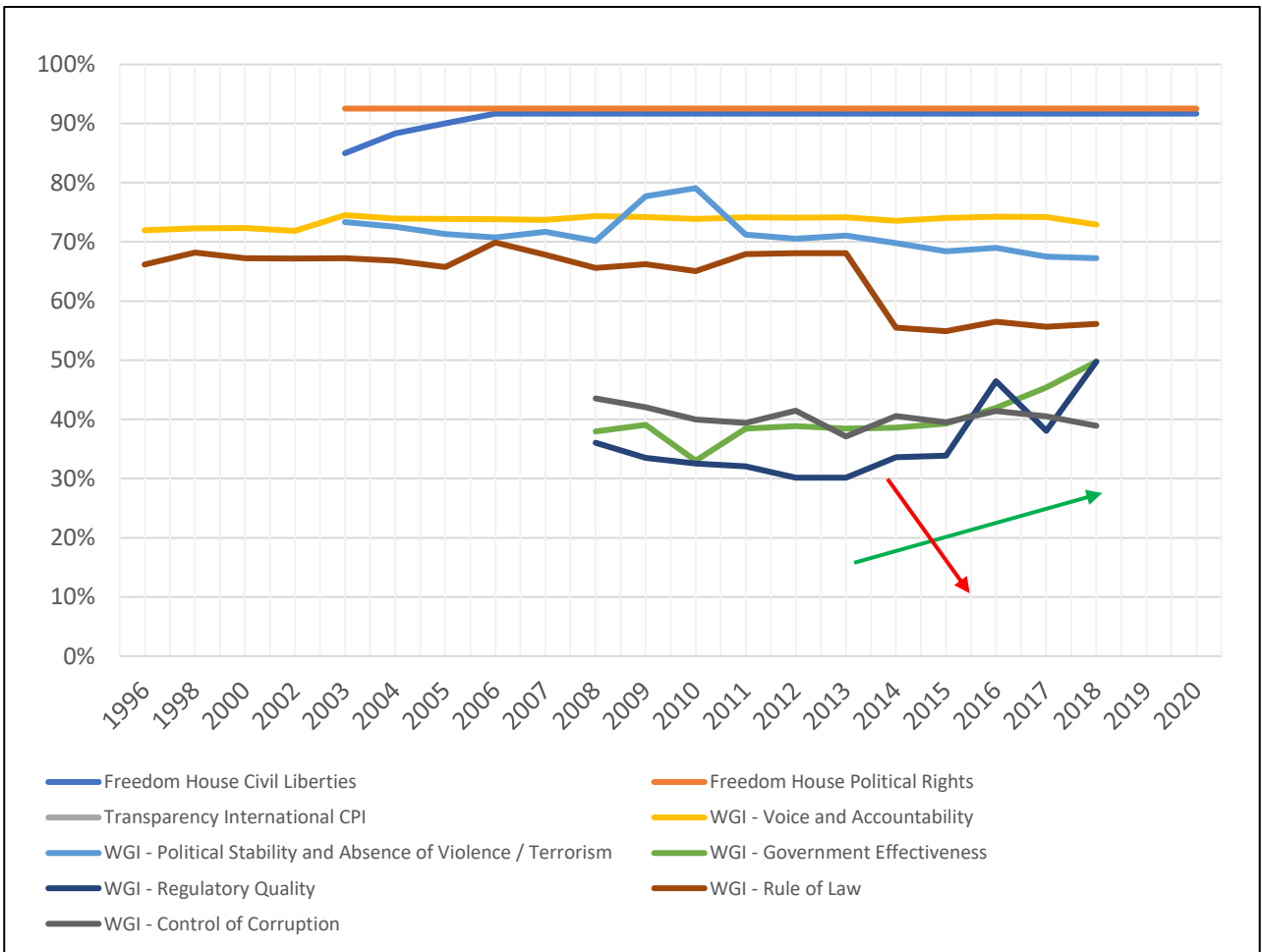
# Palau



Palau was not included in this study due to sparse data.



Source: Lowy Pacific Aid Map ©2019

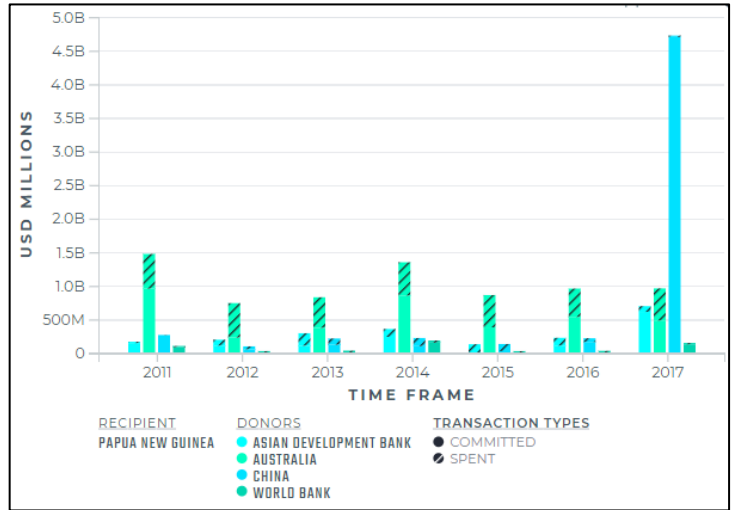




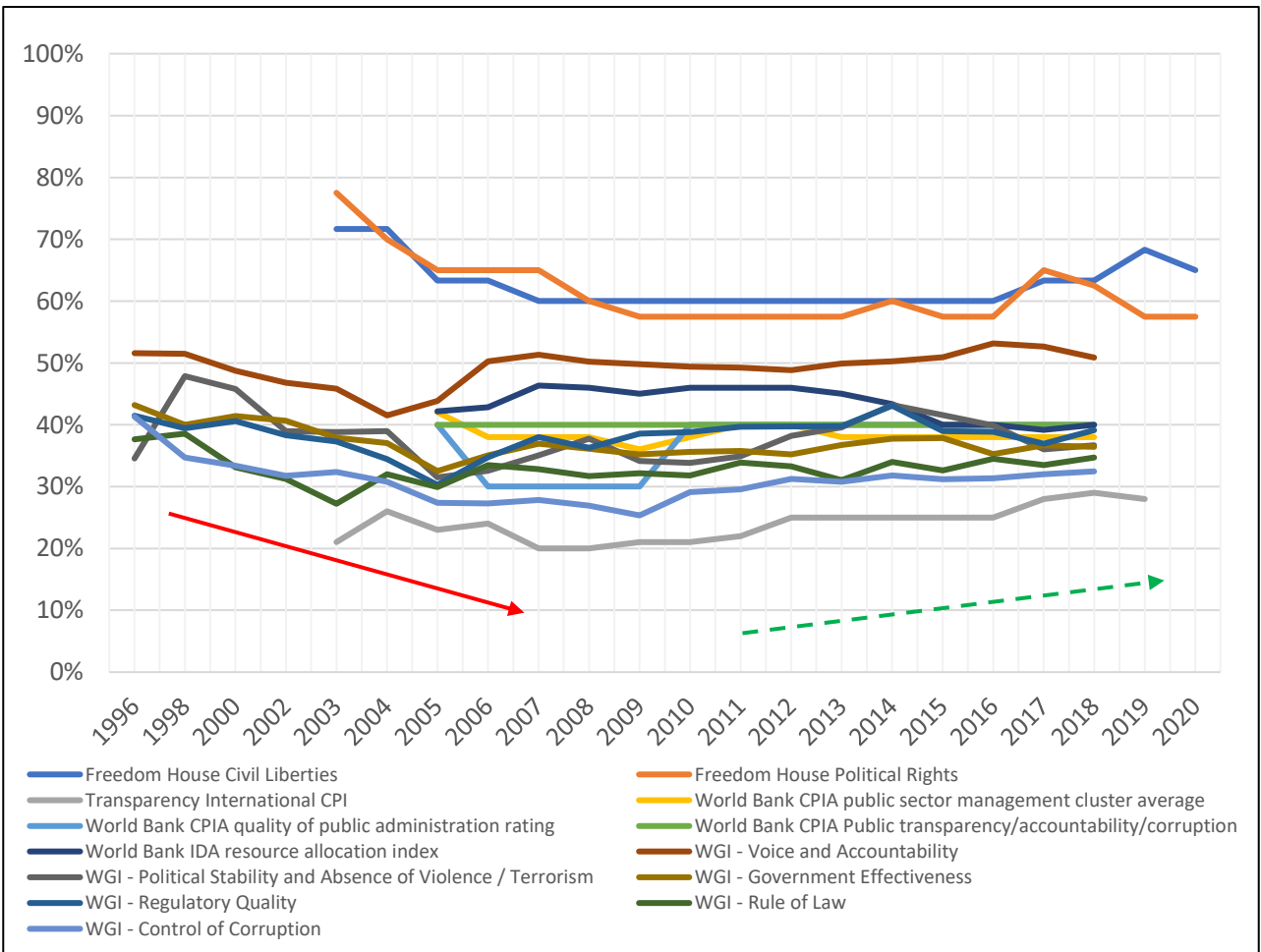
# Papua New Guinea (PNG)



PNG was not included in this study due to diverse factors that set it apart from the rest of Oceania.



Source: Lowy Pacific Aid Map ©2019



# Samoa

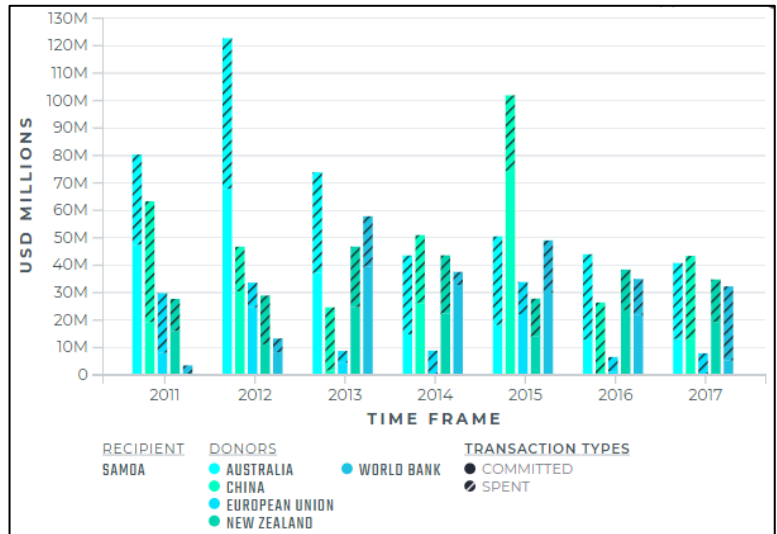


China is a major lender to Samoa with over \$231.3 mil in loans and grants between 2001-2017. Three of the top 5 projects in Samoa were funded by China.

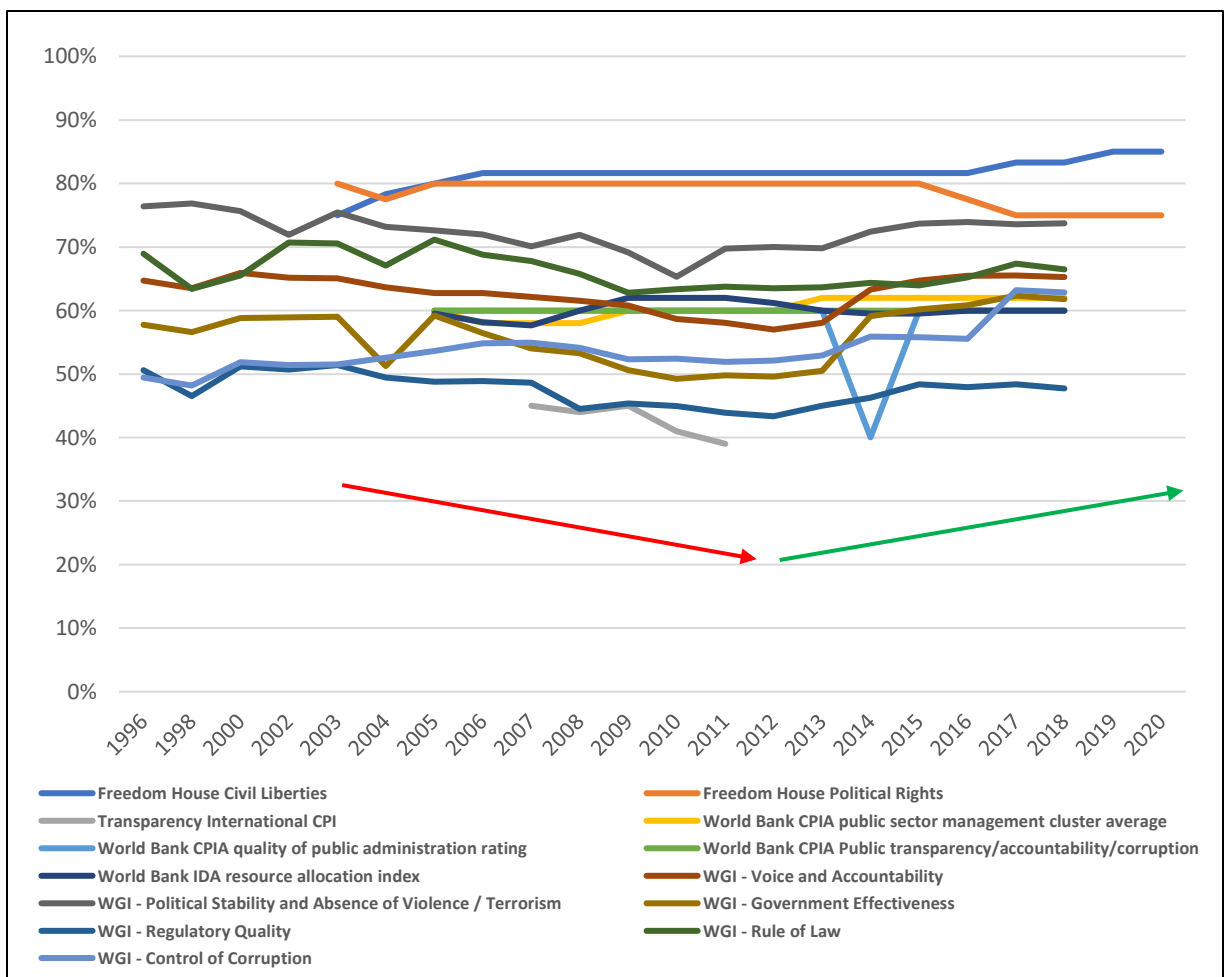
## Significant Events

2006 - \$52 mil PRC loan for conference center (construction began 2010).

2015 - \$60 mil PRC loan for airport upgrades – largest aid project from any country.



Source: Lowy Pacific Aid Map ©2019



# Solomon Islands



Solomon Islands had no diplomatic relations with the PRC until late 2019. Australia is the largest donor.

## Significant Events

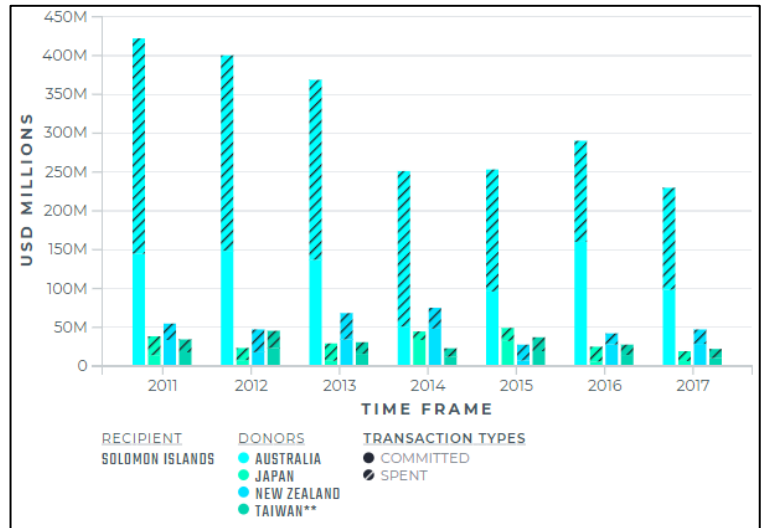
1999-2003 – Civil war

2006 – Chinatown burned

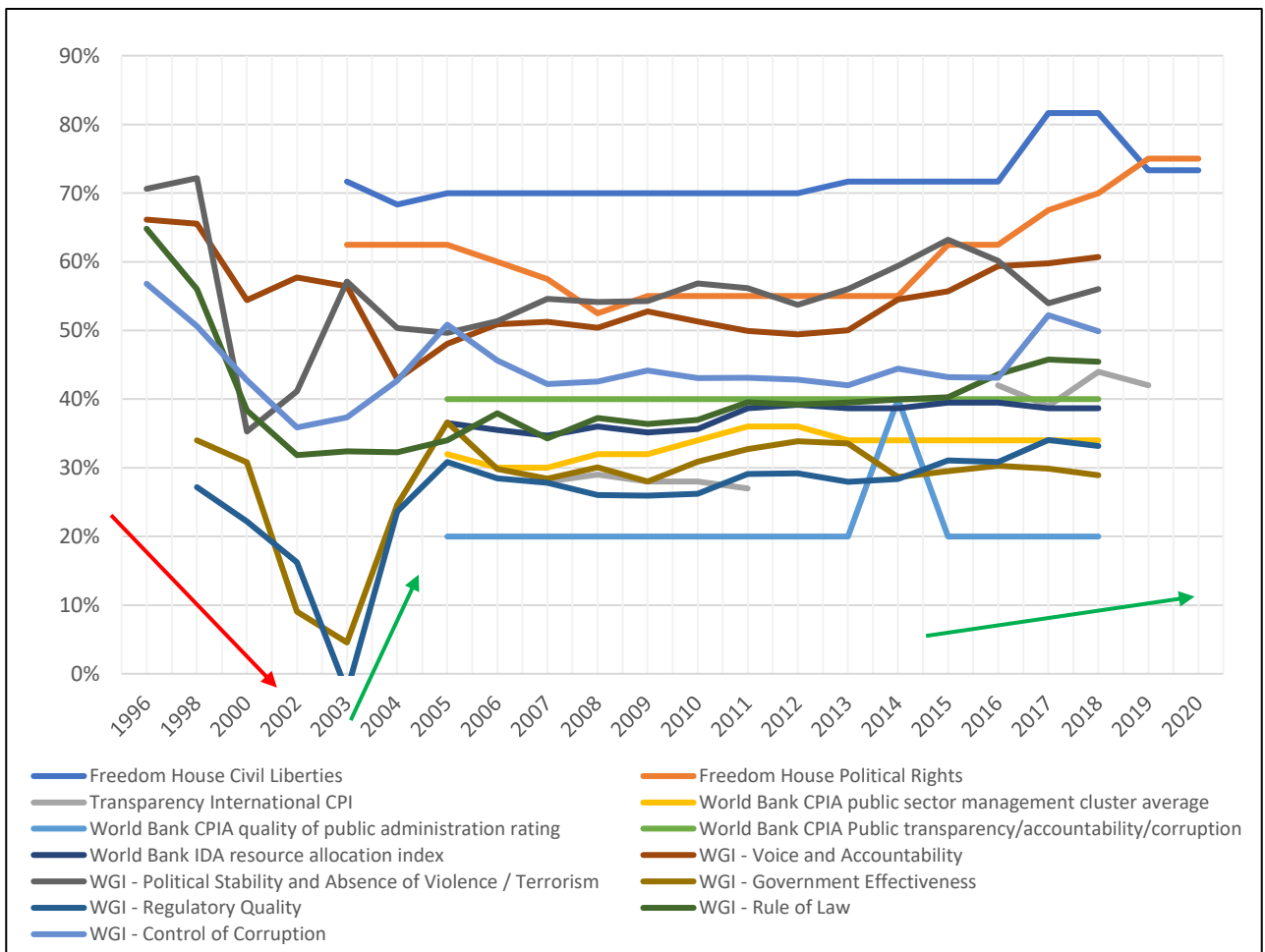
2011 - \$87.8 mil grant from Taiwan (payable through 2018)

2015 - \$20.4 mil Japanese grant for port facilities

2019 – Diplomatic relations switched to PRC; Tulagi Island leased; mine re-opened.



Source: Lowy Pacific Aid Map ©2019





# Tonga

China is a major lender to Tonga. Tonga has renegotiated loan terms several times and is having trouble meeting payments. China holds greater than 50% of Tonga's national debt.

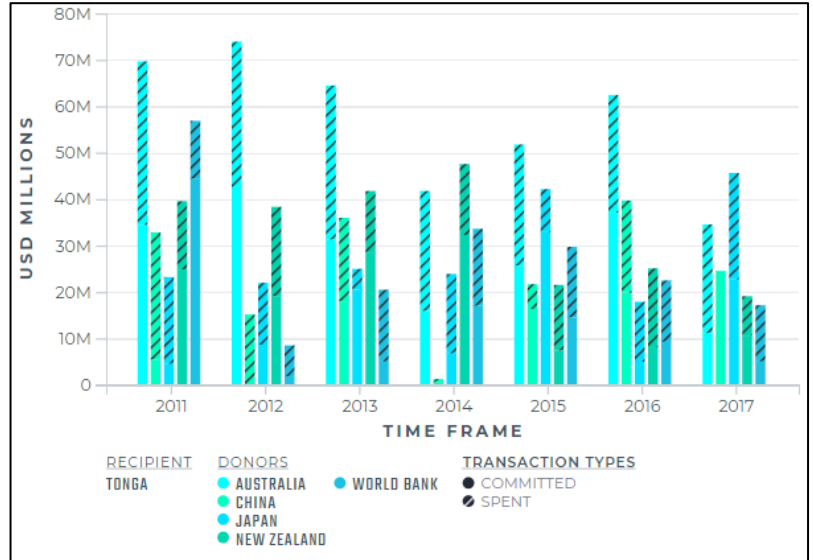
## Significant Events

2006 – Nuku'alofa riots. China provided a \$63.3 mil loan to rebuild.

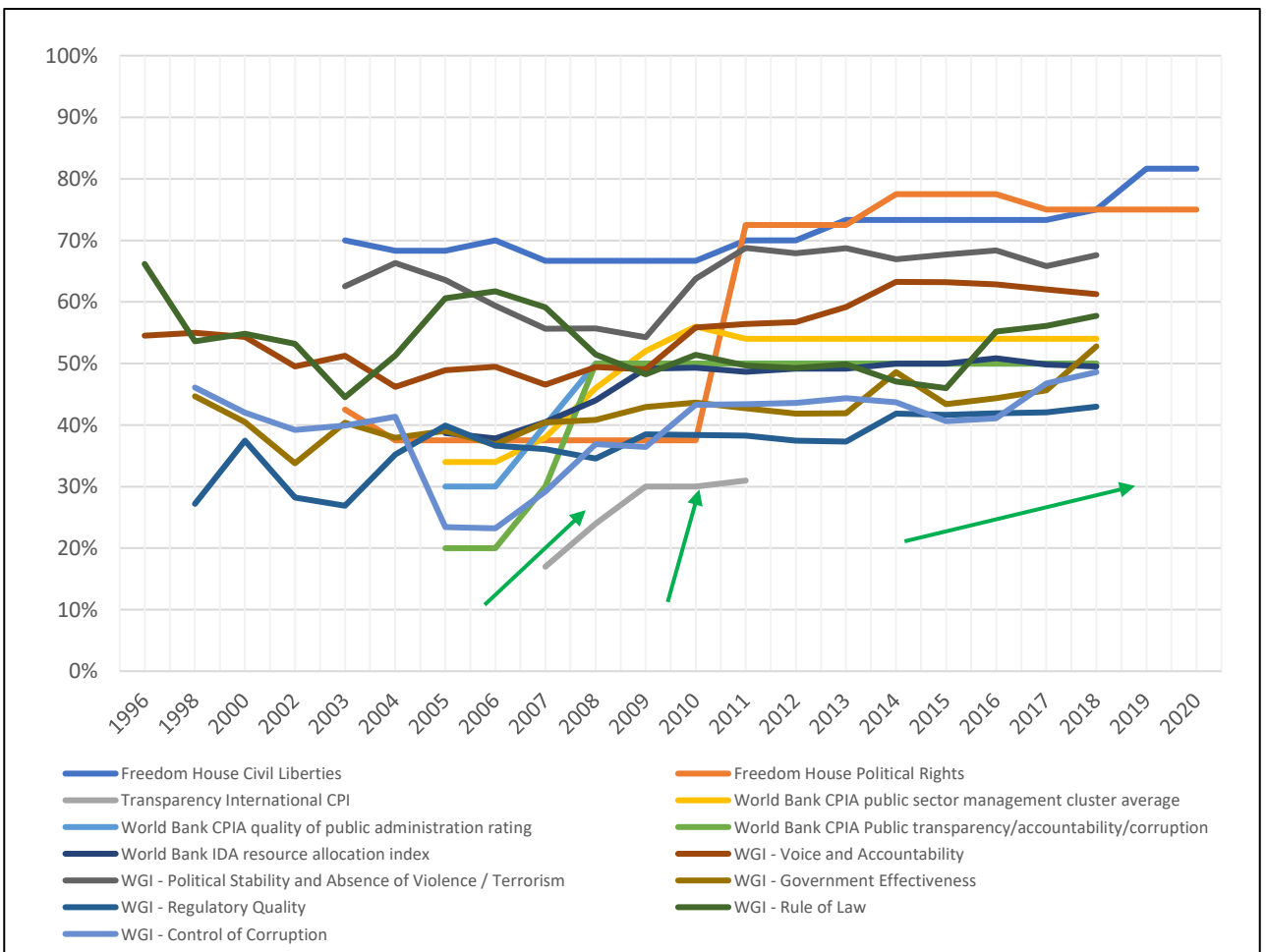
2008 – Free elections

2010 – \$44.4 mil Chinese loan for road improvements.

2016 – significant single-year PRC funding increase



Source: Lowy Pacific Aid Map ©2019



# Tuvalu

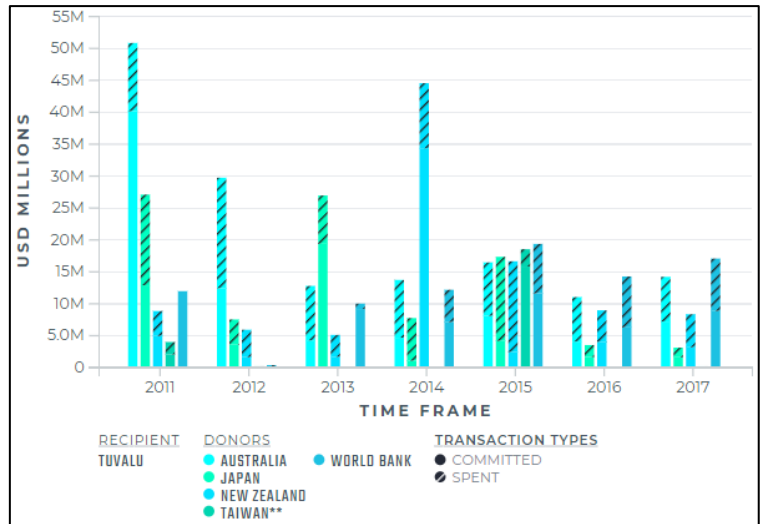


Tuvalu does not recognize the PRC, and is a strong ally of Taiwan. Australia is the largest aid donor, although New Zealand makes large contributions. Taiwan has contributed very little

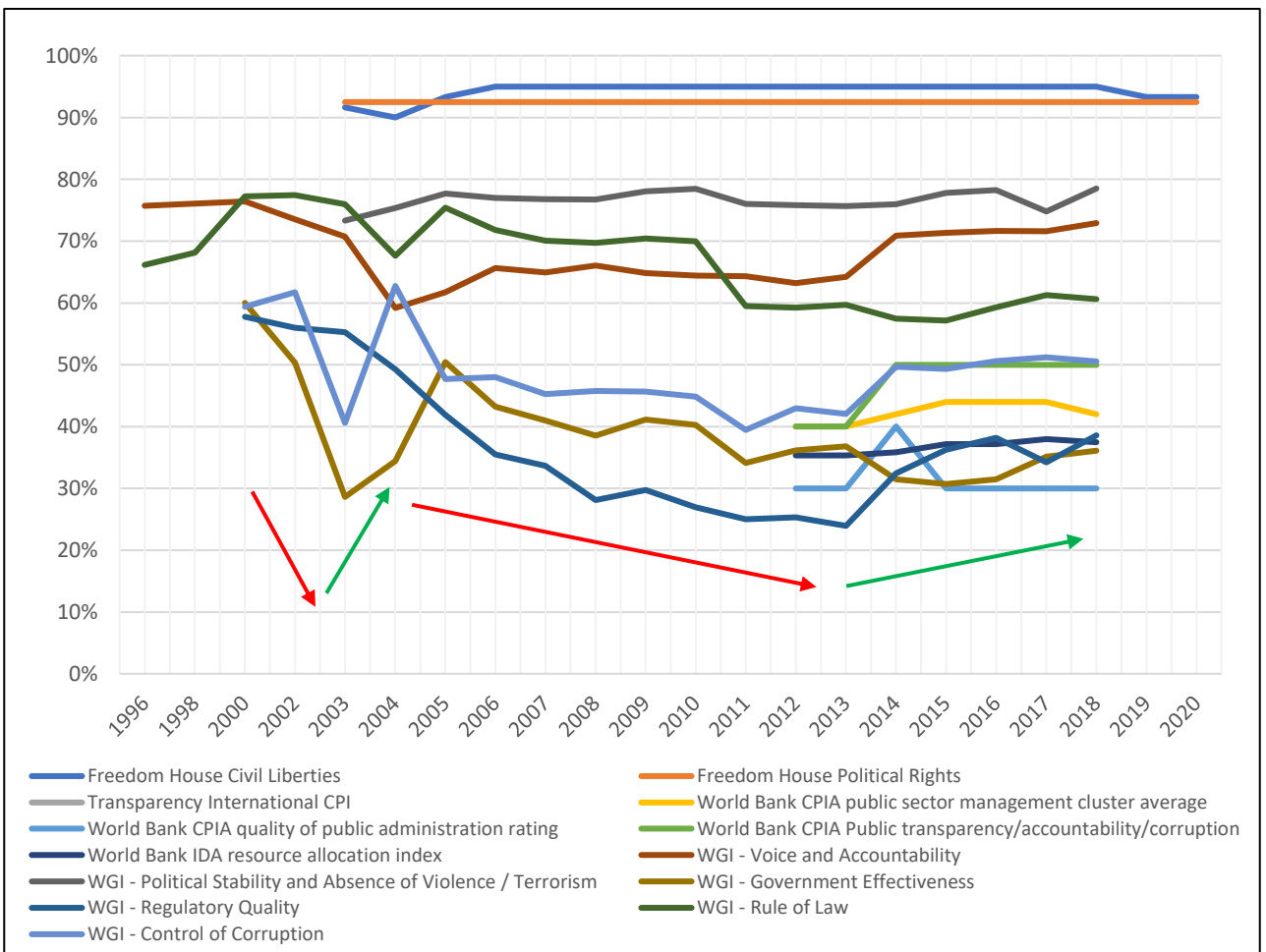
## Significant Events

2011 – World Bank \$19 mil grant (payable through 2019)

2015 – Tropical cyclone prompted emergency response. Taiwan promised \$16 mil, but only delivered \$2.7 mil.



Source: Lowy Pacific Aid Map ©2019



# Vanuatu

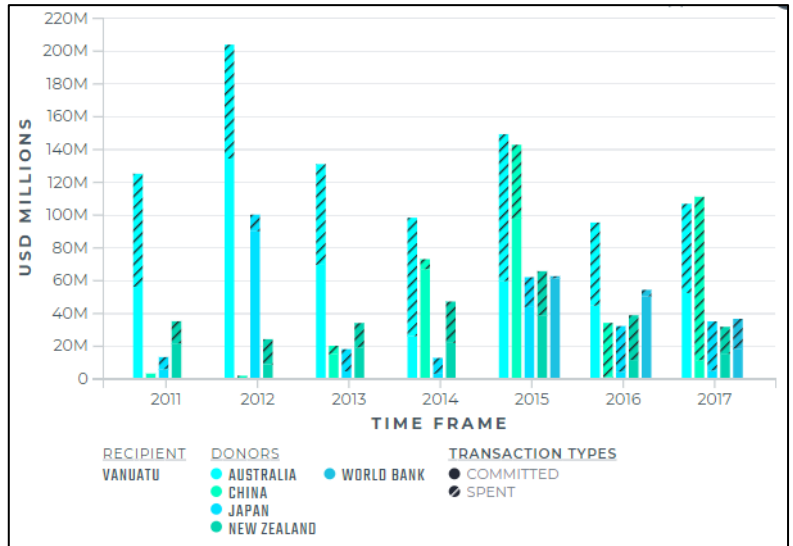


China is the primary lender to Vanuatu in recent years, and holds a large portion of the national debt.

## Significant Events

2014 – Luganville wharf project announced (\$86 mil PRC loan)

2018 – Luganville details released



Source: Lowy Pacific Aid Map ©2019

