



## Japan's Dilemma and AIIB

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Japan is grappling with a dilemma over joining China led Asian Infrastructure Investment Bank (AIIB) ever since Beijing announced its creation as a new lending bank, which is being dubbed as an alternative to the existing banks led by the West, including Japan led Asian Development Bank (ADB). When China mooted the proposal of forming an infrastructure bank and asked various countries, including Japan, to join this bank as founding members, an interim report of the Japanese government on the AIIB suggested to its leadership to look at a set of positive and negative points, while taking a final decision. The positive points cited by the report were:

- a) Japan can be directly involved in the “rule-making process” of the bank.
- b) Japanese entry could lead to “improved relations” between Tokyo and Beijing.

The negative points identified were:

- a) It will hurt ties with the United States.
- b) Japan may end up giving “legitimacy” to a Chinese plan “to bring developing countries into its economic sphere of influence.”

China had fixed March 31, 2015 as the deadline for the countries wishing to join the bank as founding members. The deadline is over and Japan has not sent its consent to join

the bank. It is obvious that Japan, by not joining AIIB at this point of time, chose not to give “legitimacy” to Beijing’s aspirations to increase its economic sphere of influence. More importantly, Japan chose to be in sync with its alliance partner, the US. The US was not willing to join this Chinese led initiative as within its strategic circles, the AIIB was viewed as a tool to challenge the post World War II international financial order created and led by the West. Therefore, it can be said that the Japanese administration, which, in most of the cases, had looked at safeguarding its economic interest over the strategic ones; this time, preferred to secure its strategic interests.

However, 57 countries including a number of G-7 countries and US’s key ally, the United Kingdom decided to join the AIIB as founding members despite knowing the perceived stance of Japan and the US. Notably, various countries in the region including South Korea and Philippines, which have differences with China and have close strategic ties with the US, also chose to join the bank as founding members.

Previously, Japan had adopted a strategy to tap vast infrastructure development opportunities in Asia for its own economic revival and when it decided not to join the AIIB, a cross section of the domestic constituencies comprising of scholars, businessmen and political parties, viewed it as a missed opportunity for Japan. The Japan Innovation Party, a minor opposition party, criticized the government, saying that the failure to join the AIIB was a “victory for Chinese diplomacy and a rout for Japanese diplomacy.” Similarly, Japanese Communist Party urged the government to join the AIIB, arguing that the “Chinese initiative highlights the fact that the existing financing framework based on the IMF, World Bank and ADB is inadequate in addressing Asia’s enormous infrastructure needs.”

It is interesting to note that the Asian Development Bank, which is led by Japan, in its own estimate, highlighted that USD 800 billion a year is needed to finance infrastructure developments in Asia till 2020. According to Japanese sources, the ADB plans to boost credit lines by 1.5 times from current levels to 20 billion dollars. However, this amount (roughly 45 billion dollars) will be far short of money needed to finance the infrastructure

projects in this region. This very reason has prompted a group of Japanese scholars and the media to suggest to the government to join the bank. They are of the view that given the vast demand of infrastructure in Asia, both the Japanese and Chinese banks can complement each other.

Japan's joining the AIIB will help assuage apprehensions from a section of domestic constituencies that the institution "could be run in discretionary ways to promote China's own interests," pointed out *Japan Times* in its editorial. The Japanese business bodies also see AIIB as an opportunity. They believe that as Japan's population ages, the demand of infrastructure will shrink domestically. Therefore, they are looking to tap infrastructure projects overseas and believe that the boycott of China led bank would be a missed opportunity for Japanese infrastructure building companies.

However, there is a counter narrative within Japan as well, which urges the government not to join the AIIB. They believe that the AIIB may be "nothing more than a policy instrument of the Communist regime" and that the AIIB is part of China's "ambition to change the international economic and financial order that the United States has built." They believe that this institution will help establish "China's regional hegemony." Yet another view urges the Japanese government to look at China's "macroeconomic stability." This view has been put forwarded by Koichi Hamada, a special economic adviser to Prime Minister Abe. Hamada thinks that "the misallocation of capital and poor investment decisions in China raise serious risks.... these domestic risks may spread to China's neighbours, raising the danger of another large-scale international crisis." He warns that the European nations, which hastily decided to join the Chinese bandwagon, may not be affected in the same manner as Japan may be, because of their distant geographical locations.

Amid these debates within its domestic constituencies, the Japanese government announced that it will assess AIIB's governance standards and transparency, especially the screening of loans and approval, before taking a decision to join the bank. It hinted that it has kept its option open to join the AIIB.

It is interesting to note that Japan has adopted a two-pronged strategy to deal with the situation emerging from the creation of AIIB. The first strategy is to join the AIIB if it meets certain conditions including transparency in loan disbursement and the second strategy is to increase ADB's lending capacity to counter AIIB. The first strategy, that is Japan's participation in the AIIB, will depend on US moves. It may be noted that like Japanese strategic community, the US strategic community is also divided over the issue of joining the AIIB. A number of American strategic thinkers have questioned US leadership's decision to sit on the fence. Fred Bergsten, Director Emeritus at the Peterson Institute for International Economics, a major US think tank, in an interview to the *Asahi Shimbun* told that "the US will eventually join" the Bank. He observed that "the United States... has urged China to play a bigger role in the region and the world economy for a number of years. But when China tries to do it, the United States opposes it. It's illogical."

Similarly, Jonathan Pollack, a specialist on East Asia at the Brookings Institution opined that "by maintaining their distance from the bank, American and Japanese responses seem problematic at best and churlish at worst." Japan is closely watching the ongoing debate in the US circles about the AIIB. The US has given various "shocks" and surprises to Japan in the past and one of them was Washington's decision to embrace Beijing in the 1970s without taking Tokyo into confidence. It seems that by deciding to contribute 1.5 billion US dollars in the event of joining the bank, Japan is keeping itself prepared to participate in the institution in case US indicates to do so and does not want to be caught off guard to avoid yet another shock.

Japan's second strategy is to counter the China-led bank by increasing its own financial lending and a swift disbursement of loans. It may be noted that ADB, which is led by Japan, is known for its slow loan disbursement procedures and, at times, it takes two years to clear a loan request. The AIIB, however, promises to offer loans to emerging economies through swift decision making process. Now, Japan is preparing a strategy to match the AIIB strength with strength not only by adopting a swift loan disbursement process at the ADB, but also by garnering USD 100 billion from public private partnership to assist infrastructure development in Asian countries.

The Japanese Finance Minister, Taro Aso, has unveiled a plan to create a framework in which the Japan International Cooperation Agency and other entities will cooperate with the ADB in this regard. Japan has hinted at this strategy after ADB's annual meeting in May 2015 at Baku, Azerbaijan, in which Aso himself participated. After the Baku meeting, ADB's President, Takehiko Nakao, said that the bank is considering seeking additional contribution from its members as a way of boosting its lending.

It clearly suggests that Japan considers the creation of the AIIB as a political decision by China to increase its influence in Asia at a time when, due to lack of funds, Tokyo's influence is waning. However, Tokyo is in no mood to let China dominate Asian infrastructure projects and is gearing up for a counter strategy to compete with China. It is clear that both will compete with each other for maintaining their influence by pouring more funds for Asian infrastructure. How the battle of influence between Japan and China over Asia will pan out in the near future would be interesting to watch. It remains an open ended question whether the commitments and declarations announced by China and Japan would match with actual financial support.

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