

Japan should influence China from within the AIIB

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FOR THE STRAITS TIMES

JAPAN should vigorously debate whether to join the new China-led Asia Infrastructure Investment Bank (AIIB), regardless of the views against it in the country.

The AIIB was first proposed by Chinese President Xi Jinping in the autumn of 2013. Beijing held the signing ceremony with 21 founding members from Asia and the Middle East in October last year, and more detailed negotiations over the governance structure are expected to be completed when the bank is officially launched by the end of this year.

“China will pick a joker,” said a former Japanese high-ranking diplomat, referring to the possibility that the AIIB may fail due to its poor practice and unprofitable projects. He likened the bank to a subprime lender giving out concessionary loans to customers with poor track records but high needs.

But this does not have to be the case. Japan needs to realise that it has little political means to block the new bank. Although the United States reportedly pressured its allies not to join the Chinese initiative, following the move by Indonesia and New Zealand, the once-hesitant Australia is now willing to join while South Korea is seriously considering doing so. Moreover, European states and Canada might also become members.

Japan has reservations about joining the AIIB in part because it

potentially reduces the influence of the Asian Development Bank (ADB), whose head has always come from the ranks of its Ministry of Finance and the Bank of Japan.

Japan and the US are the largest shareholders of the ADB. In retrospect, the two countries could have put more effort in the World Bank and the International Monetary Fund to accommodate the interests of China, and to make the ADB less Japan-dominant.

Failing to reflect the voices of the emerging economies, these institutions are at risk of being marginalised in the long run.

When the Asian financial crisis hit the region in 1997, Japan proposed the establishment of an Asian Monetary Fund, but saw failure in the face of strong opposition from Washington.

Subsequently, Asian countries started an endeavour to deepen cross-border financial cooperation. The regional financial markets are growing but still undeveloped to be able to effectively channel the savings glut to where development is needed within Asia.

Now that the AIIB is set to emerge, Japan can and should try to exert its due influence from within. Singapore, the only advanced economy among the founding members, hopes Japan can jointly carry weight with the governance structure.

The Chinese way of infrastructure building has not only met with some backlash in Africa, but has also led to disruptions of projects like the Myitsone Dam in Myanmar. Not being a member of the Organisation for Economic Cooperation and Development,



Japan's participation in the Asia Infrastructure Investment Bank would promote its own infrastructure business, which the government has been pushing.

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China is not bound by the stringent conditions and safeguard policies of its Development Assistance Committee.

To this end, Japan could assist in the best practices in the AIIB in the fields of environmental protection, relocation of locals, employment creation and human rights.

China's influence in AIIB

ONE needs to pay attention to the macroeconomic environment sur-

rounding the AIIB. China aims at reducing overcapacity at home, enhancing the liquidity of offshore yuan, promoting the “going out” of domestic firms, and employing its huge foreign reserves to acquire assets overseas.

The outflow of foreign direct investment by the state-owned enterprises (SOEs), however, is worrisome as their average return is well below that of private firms, and even substantially less than the cost of capital. This is especial-

ly true for infrastructure-related sectors, including electric power, rail transport, upstream oil and gas, financial services and telecommunications. The AIIB's investment in these sectors may proliferate the inefficient practice of the SOEs outside China.

China has been swift to respond to huge and acute infrastructure needs in the developing world, in contrast with lengthy project processes required by other lenders.

On the other hand, local governments in Asian countries may demand funding for projects out of political interests. China's financing approach and the recipient's motivation may not generate an environment that is conducive to channelling capital to sustainable development in the region.

Indonesian President Joko Widodo, in his speech to the Apec CEO Summit in Beijing, apparently expressed his concerns about the impact China's infrastructure export will have on Indonesia.

Japan's role

JAPAN'S participation in the AIIB would not go against but, in fact, promote its own infrastructure business through access to the information and resources within the AIIB.

The Japanese government has been pushing the export of package-type infrastructure, in which domestic firms are involved in everything from designing to financing since 2010.

Japanese Prime Minister Shinzo Abe has pledged to continue this effort and triple the export of in-

frastructure-related business to 30 trillion yen (\$345 billion) annually by 2020, with a strategic focus on power stations and high-speed rail.

On the financial front, the Japanese Exchange Group, an operator of the Tokyo Stock Exchange and the Osaka Securities Exchange, aims to be Asia's infrastructure hub. Meanwhile, Japanese commercial banks are expanding to the Asian region and gaining strength in project finance.

The leaders at the G-20 Summit in Brisbane last year recognised infrastructure demand in the developing world as a new source of global growth in the aftermath of the global financial crisis.

Based on an ADB estimate, infrastructure demand in Asia through 2010 to 2020 will be US\$8 trillion (\$10.8 trillion), which is far beyond the capacity of the ADB.

The launch of the AIIB can be seen as evidence that China is finally stepping up to be a responsible global stakeholder.

The relationship between Japan and China has worsened in the past few years. Putting historical and territorial issues aside, the AIIB presents a great opportunity for the two largest Asian powers to cooperate in the economic sphere, so as to provide public goods to a broader Asian region.

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