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On

**“Can China and Japan Afford to
Debase Their Economic Interdependence?”**

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Can China and Japan Afford to Debase Their Economic Interdependence?

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Abstract: Recent developments between China and Japan, both political and military in nature, are seemingly shaping a collision course and creating tensions in their bilateral economic relations. This situation demands an investigation on the ramifications of these developments may have on their future economic dealings. Economically, both countries are important to each other and any adverse happening is likely to have a bigger long-term impact on their economies. This is because of the depth and width of the economic and financial engagement developed between them. On the one hand, China is now the biggest trading partner of Japan; their bilateral trade constitutes about US\$340 billion a year. Japan, on the other hand, has a substantial amount of investment in China, amounting to \$98.1 billion in 2014. All the major Japanese companies are now deeply engaged in production in China and it is a strategic spot in their international supply chain. Similarly, short-term Japanese portfolio investment is playing an important role in the Chinese stock markets. Beyond these economic and financial linkages, Japan, in recent years, has been seeing an increasing number of open-wallet Chinese tourists to the delight of its sluggish economy. So any disruption of this inter-connection is bound to have greater economic implications. The proposed paper examines the possible impact of any adverse developments on the interdependent economic relationship between China and Japan and concludes that they should try to avoid conflict as they need each other for their mutual economic benefits.

Keywords: Japan, China, Economic Interdependence, Debase

1. Introduction

For the last three and a half decades, China and Japan have evolved into two hugely interlinked economies to develop one of the biggest economic partnerships in the world. Individually, China is now the largest trading partner of Japan, constituting about 1/5th of its trade. Similarly, Japan holds the 2nd place, just behind the United States, as a trading partner to China. Their bilateral trade stood at \$340 billion in 2014, forming the third largest partnership in the world. Not only that, Japan has the highest amount of FDI stocks in China, about \$99 billion in 2014, which is almost equal to investment stocks it has in four other newly industrialized

economies, viz. Hong Kong, South Korea, Singapore, and Taiwan (JETRO, 2016). On the other hand, a small amount of Chinese investment is flowing in Japan annually. In addition, their economic weight has added further prominence to this economic linkage as they are the second and third-largest economies in the world; together they now account for more than one-fifth of the global GDP (Drysdale, 2015).

Japanese Official Development Assistance (ODA) to China is one of the issues with economic dimension that is not much discussed in the context of the economic interdependence. In fact, the Japanese ODA flow to China began in 1979 after the Treaty of Peace and Friendship between Japan and China signed in 1978. This assistance was used mainly to upgrade various Chinese infrastructural needs. Though this has helped the Japanese businesses in China but fact remains that this has complemented China's industrialization process as well. A lot of large-scale economic infrastructure projects were targeted under ODA and these projects have played a significant role in the realization of China's current economic growth (MOFA, 2016). Though ODA from Japan to China now has stopped due to its upgraded economic condition, its importance has to be viewed in terms of its contribution to the economic and social development of China.

In this paper two other factors have been identified which are supposed to have been playing role in developing the economic relationship between China and Japan. They are the flow of portfolio investment from Japan to China and increasing level of tourism from China to Japan. The stock market rout in China in 2015 and 2016 is seen as an opportunity for the Japanese short-term investors to invest. On the other hand, Japan has been seeing an increasing number of open-wallet Chinese tourists to the delight of its sluggish economy. During 2015, more than 4.99 million Chinese tourists visited Japan and have accounted for 40.8 percent of total money spent by the foreign tourists (Otake, 2016). This is sort of net income mostly of the local industries spreading over a broad spectrum in the

economy. So, any disruption of this inter-connection is bound to have greater economic implications.

The importance of this economic interlinkage between China and Japan has to be evaluated from the mutual benefits it has brought to both the nations. Indeed, the antecedents of the interdependence lie in the complementarity of the two economies and the way that changed over time (Armstrong, 2012). From the very beginning, they had different levels of industrial and technological capability and their economic interactions created a sort matching demand and supply relationship that made them complementary to each other. For instance, this economic partnership with China helped Japan achieve large-scale externally-driven growth and overcome the economic downturn it faced due to the asset bubble burst in the early 1990s. Not only that, all the major Japanese companies are now deeply engaged in production in China and it is a strategic spot in their international supply chain. Similarly, China was really helped by the engagement to catching up the frontier of industrial technology and much-needed access to investment and this generated the space for business in China on a scale not matched by any of its other business relationships (Armstrong, 2012; Drysdale, 2015). Access to external investment and manufacturing technology including that from Japan has transformed China not only into a manufacturing powerhouse but also an export hub of products for all in the world. The welfare effect in Japan out of cheap imports from China is not very small either.

In the relationship between the two, the non-business risk has been emerging to be a big factor in recent years. Developments between China and Japan, both political and military in nature, are seemingly shaping a collision course and creating tensions in their bilateral economic relations. As we now understand that, economically both countries are important to each other, and any adverse happening in the economic arena is likely to have a bigger long-term impact on their economies. This is because of the depth and width of the economic and

financial engagement developed between them. Not only that, any adverse relationship between them may have adverse ramifications for the immediate regional countries and for the broader global economy because of the extensive networks of global supply-chain originating from China and the size of their economies. While looking on the impact issue, we essentially have to keep in mind that trade is prone to more immediate impact than investment. This is because of the fact the investment decisions occur with a longer time lag, consequentially any shift in the base will also be taking longer time even though country risk might emerge. On the other hand, trade can be impacted quickly as demand and supply equation changes and the parties in the both sides can relatively easily switch locations when circumstances change (Armstrong 2014).

Along with the recent ‘ice cold’ politics, a number of other factors have been in the play to create this sort of uneasiness between the two neighbors which have shown the potential to spill over in the economic and business areas. Though the situation demands an investigation on the ramifications of these developments, but focus of the paper mostly remains economic in nature. But references may be made on the issues that may have implications on their future economic dealings.

The objective of the paper is to examine the possible impact of any adverse developments on the interdependent economic relationship between China and Japan. In doing so, it also examines the factors that are creating a fear of any debasing of the interdependence and recent trend of some of the indicators. In the process, it also identifies some of the factors that will play their part to shape the economic relationship between these two giant economies.

This paper has six more sections to follow. Section two gives a brief review of literature. Section three delineates the how the economic interdependence has grown over the years. Section four deals with some trending factors that are creating fear of a sudden breakdown of the economic interactions between the two

economies. But there are some factors, discussed in section five, that may act as the leverage for shaping the future economic relationship between Japan and China. Objectively, both China and Japan need each other for their respective economy as well for a better Asian economy in the 21st century. That is explained in section six. Section seven concludes the paper.

2. Literature Review

The present paper has a broader canvas for depicting the interdependent economic relationship of China and Japan and factors or leverage that may help continue the relationship or impede it. The primary strand of literature deals with trade and investment issues of the economic relationship. But some of the other issues that this paper wants to cover have little or widely scattered references.

The interdependence issue has arisen probably because of the economic rise of both Japan and China. Earlier, while Japan has sometimes been labeled ‘an economic giant and political pygmy’ (Inoguchi, 1991: 1), one might have been tempted to describe China as a political giant and economic pygmy. However, today, China is a giant in both respects (Alvstam, et al. 2009).

The opening up of the economy was important for the Chinese economic rise. But the Asian financial crisis in 1997 indirectly helped China to be a better investment option as it remained unscathed by the crisis. Moreover, the prospects for a future WTO accession favored further investment in China including that from Japan. Not only that, a policy shift from ‘hub-and-spoke’ bilateralism, which had been a typical feature in Japan’s relationships with separate Southeast Asian countries, FDI from Southeast Asia gradually moved to China, a signature to a more multi-tiered form of regionalism (Ashizawa, 2003: 361)

But again, from a risk-averse motivation to cost reduction method, a shift in the direction of Japanese started appearing under a strategy called “China plus one”

(JETRO, 2007b). The JETRO study shows that this happened despite the attractiveness of the Chinese market in terms of local purchasing power and as an export base. Under the strategy, Japanese firms wanted to invest in another country or region to counterbalance their investment (and risk) in China (JETRO, 2007; *The Economist*, 2007). According to the JETRO study, Vietnam, Thailand, and India have also risen to become important locations for overseas expansion as Japanese companies were facing number of constraints like underdeveloped legal system and problems with legal procedures, problems with protection of intellectual property rights, tax issues and high/increasing labour costs as a business risk in China. Some even expressed concern about political and social instability in China (JETRO, 2007). Other studies have complemented the results of the JETRO study.

Alvstam, Strom and Yoshino (2009) have done a comprehensive study on the economic interdependence between China and Japan and concluded that the countries have much to gain from their economic interdependence. The study finds that the firms see great potential in their respective markets but are concerned about political turbulence. They draw three possible scenarios for the future economic relationship between China and Japan. These are - avoidance or acceptance and distance, where Chinese and Japanese companies will avoid competition and expand primarily in different markets; cooperation and mutual leverage where Chinese and Japanese companies will extend their mutual cooperation in order to join forces in competition with European and American companies; and, intense competition and rivalry in all markets. The study opines that the first scenario is unlikely; the second scenario may be realized outside China and Japan, and the third alternative is most likely to happen in the domestic markets in both countries (Alvstam, et al. 2009).

In one study, Armstrong (2012) concludes that while economic relationship is not independent from politics, for China and Japan, trade has not significantly

diminished or disturbed by the developments in politics. The same author concludes, “Measured against potential trade, the bilateral trading relationship of Japan and China has been above and beyond what they have achieved with other trading partners and the average realisation of potential globally. Trade has been driven by the two countries’ geographical proximity, their complementary economic structures, and the rapid growth of China’s economy” (Armstrong, 2012: 12).

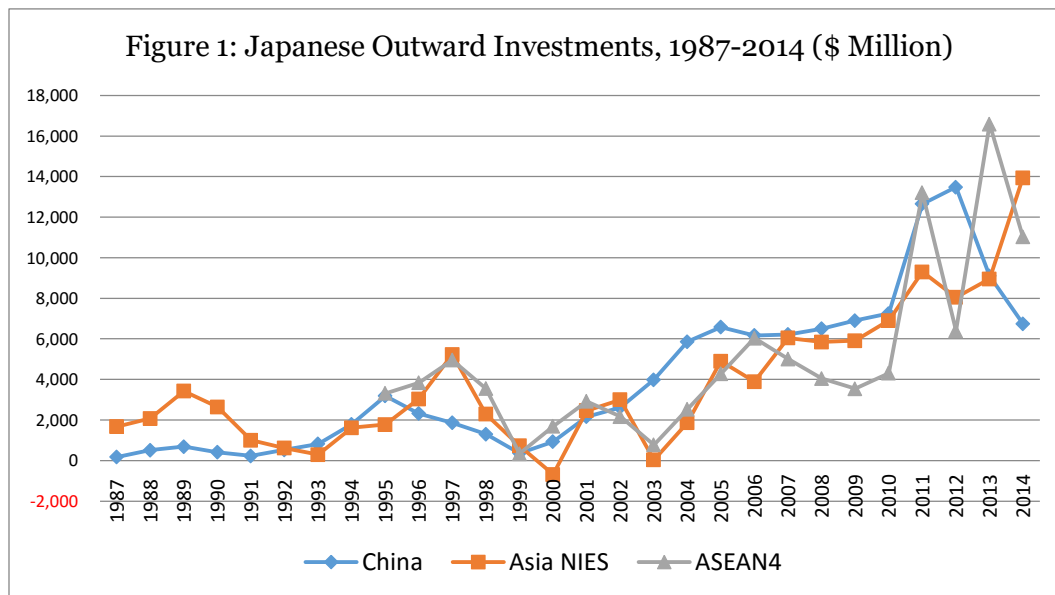
The studies reviewed, however, have not included some of the issues which have been identified to have added the depth of economic interdependence between China and Japan. The present study deals with some of the trending factors that are creating fear of a sudden breakdown of the economic interactions between the two economies and identifies some leverage factors for shaping the future economic relationship between Japan and China.

3. Growth of the Economic Interdependence

Though Japan and China are historically linked to each other for thousands of years, their modern day economic relationship is not too old as it began to flourish after China initiated the economic reform process from the late 1970s. Since then, the bilateral economic interactions developed into a substantial bloc even with ups and downs in the political relationship. Through trade, investment of both short and long term, ODA support and they have evolved into a massive interdependent economic relationship, though, excepting trade, these factors have a Japanese lopsidedness. However, in recent time, Japan has been experiencing a welcome economic phenomenon in the form of Chinese citizens touring Japan. So, in our discussion, we would like to identify these factors as the stepping stones for the development of economic interdependence between them.

A. Investment

The opening of the Chinese economy in the 1980s also opened the gate for the Japanese companies which were among the first to take the advantage. Internally there were some pushing factors for relocating their production base abroad as well, including the increase in cost of production due to huge wage rise, graduation of the manufacturing base from factor-based to high-value-added efficiency-based production, appreciation of yen, etc. So with its lower wage rate, massive supply of workforce and relative nearness in physical location placed China as a perfect destination for Japanese manufacturing relocation drive. In fact, China offered advantages to the Japanese companies as an export base for shipment to Japan, a base for exports to third countries and a huge green domestic market for their Chinese production (Alvstam, et al. 2009).



Note: Asia NIES are Hong Kong, Taiwan, South Korea and Singapore and ASEAN4 includes Thailand, Indonesia, Malaysia and the Philippines.

Source: JETRO, 2015.

Those advantages also shaped the categories or patterns in the wave of Japanese FDI to China. While as an export base for shipment saw investment in metal and chemical sectors, the second form of investment wanted to create a base for production supply-chain for Southeast Asian as well global markets. The 1997 financial crisis in the East and South East Asian countries enhanced the attraction for the Chinese market further to the Japanese MNCs. The third one was an incidental but significant advantage for the Japanese companies, matched by the rapid rise in economic growth and purchasing power of the Chinese people.

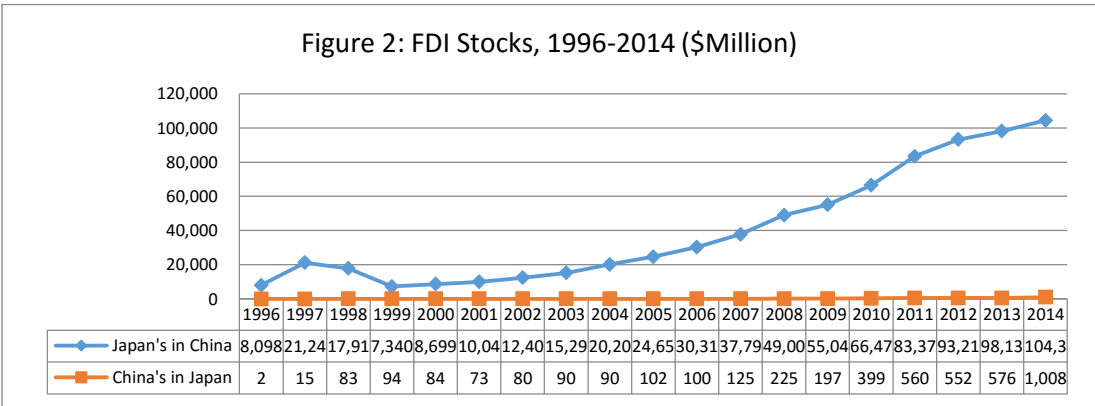
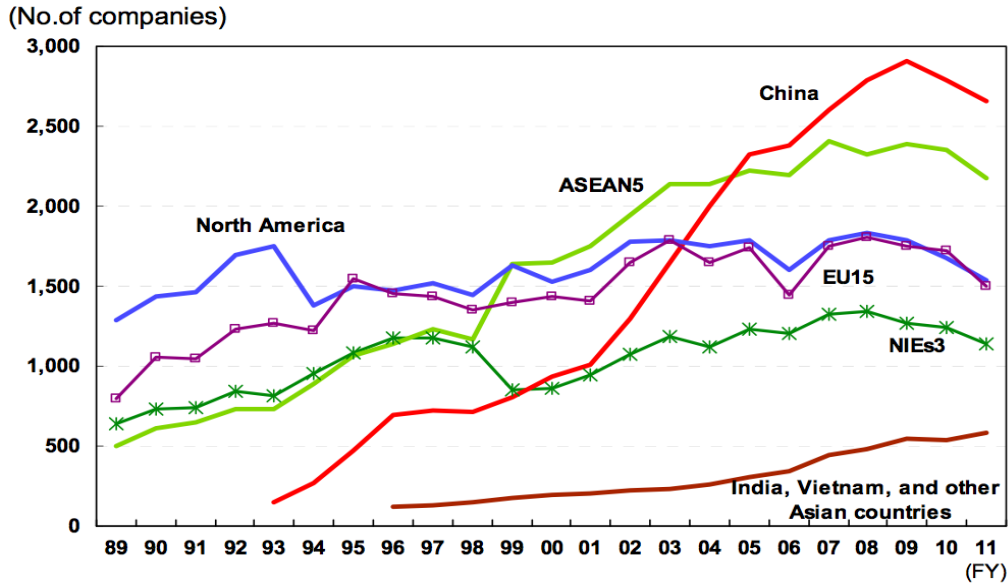


Figure 3 gives us a very divergent picture of reciprocal FDI stock positions of Japan and China in the opposite countries. In general, Japan has not a very good record as a host country of FDI from outside. Even then, the Chinese FDI stocks in Japan cut a dismal figure while compared with it total flows in different parts of the world.

The increased Japanese FDI flows have been reflected by the participation of Japanese business affiliates in China. From the 1990s, the number has substantially jumped over the years, and China houses most number of Japanese subsidiaries. Their participation has not only ensured production, employment growth in China but also increased level of trade between the two countries.

Figure 2: Number of Japanese Overseas Affiliates



Source: JBIC Report 2012.

Does the Japanese FDI bring the host countries economically closer? While examining the relationship between FDI outflows and Japanese trade patterns, Bayoumi and Lipworth (1997) find the impact is significant. Their estimation suggests a temporary impact on exports mainly through the short-term need to equip new factories while making greenfield investment. The study also suggests that a higher stock of Japanese FDI permanently affected imports from overseas affiliates. Even so, China has become the largest trading partner for Japanese exports, showing that even exports can reach a strong position over time after substantial FDI made over a long period of time (IMF, 2005; Alvstam, et al. 2009).

B. Trade

Growth of trade between Japan and China has remained a success story and a vital factor of economic interdependence between them. Though initially it began with a small figure, the bilateral trade has grown over the years and in 2014 it constituted about \$344 billion.

Like its trade relations with many of the countries in the world, China has become a net exporter to Japan. In the measure of dependency, in both exports and imports, Japan has become more dependent on China than any countries in the world.

(to be developed)

C. Portfolio Investment:

Japanese portfolio investment in China is not that significant or as a market it has remained small but is becoming increasingly important. Moreover, some Japanese investors are interested to use the Chinese stock market rout as a short investment opportunity on the expectation of growth of the Chinese companies and prices of their stocks.

At the end of 2014, holdings of Japanese Chinese stocks by the Japanese portfolio investors increased 67 percent to about \$13.0 billion (Narioka, 2015). The easy money policy of Quantitative Easing by the Bank of Japan has made the option more attractive.

D. ODA

An economic component that was supposed to have assisted the economic integration is the Japanese Official Development Assistance (ODA) to China. Though this has helped the Japanese businesses in China but fact remains that this has complemented China's industrialization process as well. In fact, the Japanese ODA flow to China began in 1979 after the Treaty of Peace and Friendship between Japan and China signed in 1978. A lot of large-scale economic infrastructure projects were targeted under three forms of finance – loan aid, grant aid and technical cooperation. These projects have played a significant role in the realization of China's current economic growth (MOFA, 2016).

They were given in three forms – loan aid, grant aid and technical cooperation. Japanese ODA to China began in 1979 and since approximately 3.3164 trillion

yen in loan aid, 157.2 billion yen in grant aid, and 181.7 billion yen in technical cooperation have been offered.

An analysis of the past ODA projects in China shows that they include large-scale economic infrastructure projects - including the building of roads, airports and power stations - as well as infrastructure projects in medical and environmental areas. For example, under Japanese loan aid a total of 5,200 km of railway lines were electrified, and approximately 60 large-size berths capable of taking ships in excess of 10,000 tons were built in the area of seaports. In addition, the China-Japan Friendship Hospital that was established through grant aid is one of the major medical institutions in the Beijing metropolitan area (Ministry of Foreign Affairs of Japan, 2016).

Due to its upgraded economic condition, Japan has stopped ODA to China. But the contributory effect of ODA has to be viewed in terms of the economic and social development of China. The projects undertaken under the ODA have come in the realization of China's current economic growth and hence a level of integration cannot be overlooked.

E. Tourism

Beyond these economic and financial linkages, Japan, in recent years, has been seeing an increasing number Chinese tourists visiting the country. The important part of it the Chinese tourists are open-wallet to the delight of its sluggish economy.

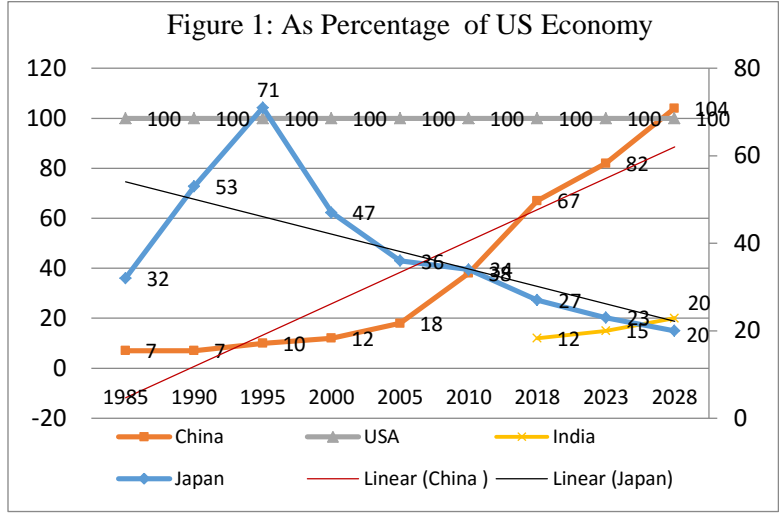
Statistics of the Japan National Tourism Organization depicts the phenomenal growth of Chinese visitors for a number of years. Say for example, in 2009, a total of 6.7 million tourists visited the country. Of them, only one million, or roughly 15 percent, were Chinese. During 2015, more than 4.99 million Chinese tourists comprising more than one-fourth of the total visitors, visited Japan. That also marked 107.3 growth from the previous year (JNTO, 2016).

The more interesting economic information of this development is that the Chinese visitors have spent more than ¥808 billion in 2015 alone. So the share of Chinese people's spending accounted for 40.8 percent of the nearly ¥3.5 trillion spent by foreign visitors (Otake, 2016). So, any disruption of this inter-connection is bound to have greater economic implications.

4. Why is the Fear of Debasement Coming?

The fear of a debasement of the interdependent economic relationship arises from three sources, mostly rooted to political, military and to some extent economic factors. And they get intermingled while discussed.

The political tension between them is emerging from the historical baggage they are carrying. During the past two centuries, Japan and China had seen their power positions shifted diametrically. Calder notes, "Historically, relations between Japan and China were clearly structured. One country was always more prosperous or powerful than the other. Before the nineteenth century, China was usually dominant; since the Meiji Restoration, in 1868, Japan has generally been preeminent" (Calder, 2006, p) as the position flipped for China and it went to a relative hibernation. But again, "The prospect that China and Japan could both be powerful and affluent at the same time has only recently emerged, largely because while China's economy and influence have grown rapidly, Japan's have remained stagnant" (Calder, 2006, p.) or declined. For China, that happened through the reforms and liberalization drive initiated in 1978 and came back at an astronomical speed economically in the global stage. By 2010, it surpassed Japan to become the 2nd largest economy in the world. Not only that, it has also replaced the US as the *numero uno* trading nation in 2013.



Source: Barai, 2015.

So in Asia, while Japan is still aspiring to maintaining the status-quo, China seems to racing to change it at the regional as well as the global level by challenging even the US-led world order.

A number of contentious developments between China and Japan could be listed which are piling up to put pressure on the respective countries to be politically and militarily assertive. For example, the counter claims on offshore oil and natural gas in the East China Sea, the territorial dispute of Senkaku Island or Diaoyu Islands, the militarization of the whole area ECS, the declaration of overlapping “Air Defense Identification Zones” etc. have the potential to escalate into a full-blown conflict between or among the nations in the region. For Japan, the Chinese claim on whole of South China Sea has a different kind of implications. The SCS Rim now houses some of the Asia countries where Japan has significant trade and investment stakes. Any disruption of peace in the area will adversely affect Japan economically. Not only has that, as an energy dependent nation, Japan has to rely on the supply of oil from the middle-east countries which passes through the SCS. So any development that has the potential to choke Japanese oil supply route has a much bigger strategic implication. But at the same time, the change in the Article 9

of the Pacifist Constitution has not send positive signal to the countries that in the past had experienced the bitter expansionism of Japanese Imperial power.

Another point that might complicate the relationship between Japan and China is the possible economic competition of their MNCs in the Asian and developed markets. So far, the economic interdependence between them is complementary in nature, but signs are there that these two economies will probably be diverging from the present framework of industrial-economic relationship. This may bring a parallelism of the fear the American revisionists once held for Japan vis-a-vis the United States. In the late 1980s and early 1990s, the American “revisionists”¹ (four figures in particular stand out: Chalmers Johnson, Clyde Prestowitz, James Fallows, and Dutch journalist Karel van Wolferen) — argued that the United States could not compete with Japan’s unique form of state-directed insider capitalism. Present government led development and economic approach in China has played a significant role in the emergence of the Chinese MNCs which have started taking over businesses or economic entities overseas. This is amply reflected by the outflow of FDI from China and their acquisition spree all over the world including the US. UK-based data provider Dealogic gives the estimate that within first five months of 2016, Chinese companies inked the highest number of overseas deals, mostly purchase of foreign companies, amounting to \$110.8 billion. This is more than their own full-year record in 2015 of \$106.8 billion on foreign acquisitions (Grocer, 2016). The domestic economic slowdown might have driven this acquisition spree, which covers the United States, to explore new avenues in overseas markets to sustain their growth.

¹ Four figures in particular stand out: political scientist Chalmers Johnson, whose 1982 book *MITI and the Japanese Miracle* laid much of the intellectual groundwork for later writers; former Reagan administration trade negotiator Clyde Prestowitz, who authored *Trading Places: How We Are Giving Our Future to Japan and How to Reclaim It* and later founded the Economic Strategy Institute to advance the revisionist viewpoint; former *U.S. News & World Report* editor James Fallows, whose 1989 article “Containing Japan” in the *Atlantic Monthly* cast U.S.-Japan relations in Cold War terms; and Dutch journalist Karel van Wolferen, author of *The Enigma of Japanese Power*. These men influenced many others—including novelist Michael Crichton, whose 1992 jingoistic thriller *Rising Sun* became a number-one bestseller.

So, it will not be unlikely that in the near future some of them might try to take over some of the ailing brand companies in Japan. That may stoke up the nostalgic nationalism in Japan. Moreover, China is trying to transform itself from a low-cost manufacturing hub to a higher level value-added manufacturing and service base. The technological innovation and their diffusion may make Chinese companies more competitive to their Japanese counterparts in the Asian and international markets.

Overall, the contest for regional leadership between China and Japan today is creating new security dilemmas, prompting concerns over Chinese ambitions in Japan. At the same time, fears of renewed Japanese militarism in China have been emboldened by various political and military moves by Japan. Both states are showing increasing assertiveness and adopting confrontational stances in political and military behavior. Their willingness to behave so is partly because of rising popular involvement in politics and resurgent nationalism exacerbated by the memories of World War II. Unfortunately, mutually beneficial economic dealings alone are not effectively soothing these tensions (Armstrong, 2012).

Though it still may be termed as periodic changes but some of the indicators of economic relations are showing a trend of weakening of the linkage. That could be a matter of concern. As Samuel Huntington noted in his landmark book *The Clash of Civilizations and the Remaking of World Order*, high levels of economic interdependence can be war-inducing instead of peace-inducing if states do not expect high levels of interdependence to continue. He also suggested, it is the trend of interaction—and not the level—that matters. When economies pull apart, nations perceive they have less interest in others' success (Huntington, 1996; also mentioned in Change, 2014). History has a lot of precedence of this type of development.

5. Factors that Should Shape the Future Relationship

So what is lying ahead of presently existing economic interdependence between Japan and China? This is a challenging question, and an element of risk is there to predict anything for the future. But we can identify some of the factors that are sure to impact the future relationship between them

A. Economic Conditions of Both the Countries

Individually, economy of both the countries is passing through a bad patch, though the situation is much more severe in case of Japan. And in our context, the economic condition of both the countries could be an important factor in determining their future.

For Japan, the hope that ‘Abenomics’ would revitalize the Japanese economy is fading as the growth and inflation rates have naggingly defeated the projection. So the economic stagnation may continue, or it may even aggravate. Though not very certain, but some of the structural changes related to corporate cash holding, corporate governance, inward investment, immigration, etc. might have brought positive results in the medium to long term. The days for only currency manipulative recipe for growth are getting increasingly numbered.

For China, the space for investment-led growth seems to have ended and the slowdown of growth around 6 percent may set the new normal rate for the future. That means the government may try to keep the growth rate in the L shape as the any possibility to make it U-shape again looks unlikely. But some of the dangers are lingering. The behavior of the debt market, external export demand, the success of the Chinese manufacturing industries to graduating to higher value-added level and so on will have an impact on the growth position of the economy.

The status-quo growth rates in both the economies or any betterment could play as a stabilizing factor in the relationship between the two countries. But any drastic decline in one or both the economies may not bode well for them.

B. Role of the Japanese MNCs which have production bases in China including their Investment Direction

Japanese companies have the tendency of following the “flying geese” model of Kaname Akamatsu with their outward investments, particularly in the developing Asia. As we know, the model has three aspects - intra-industry aspect, inter-industry aspect and international aspect. In China, most of the investment of Japanese MNCs has come to fuller circle of the second aspect and now many of them might be looking for the international aspect of the theory. The second aspect speaks about the sequential appearance and development of industries in a particular developing country, with industries being diversified and upgraded from consumer goods to capital goods and/or from simple to more sophisticated products. Once this is fulfilled, companies should be engaged in subsequent relocation process of industries from advanced to developing countries during the latter's catching-up process. This seems to be happening in China and some of the other countries have emerged to be attractive options to make the full circle of the flying geese model. Vietnam, Indonesia, Myanmar, the Philippines and a bit far country India may fit in the model for relocating the Japanese industries. In case of a sudden Japanese exodus from China, though practically sounds infeasible, will reduce the integrative strength of the relationship between them.

C. Japanese Deepening Relationship with SCS Rim countries, India and Australia

Japan seems to have made the political decision to deepening the relationship with the South China Sea (SCS) Rim Countries. This is reflected by its increasing economic, political and military involvement with the Philippines, Vietnam, and Indonesia. It has a strong economic relationship with Thailand. The recent announcement of more than \$3 billion economic aid to the development of Mekong Delta zone comprising Vietnam, Cambodia and Laos looks to be extension of the deepening relationship policy. India and Australia are the two important countries that will play important role in power matrix of the Asia Pacific region.

In the past, Japanese companies have shown their willingness to move in the direction supported by the government. This is what the American Revisionists termed as the 'state-directed insider capitalism'. There is no indication that any exception will happen if the Japanese government makes any political decision to lower the economic interdependence with China.

D. Role of the United States

One has to watch carefully the developments in the relationship between Japan and the USA vis-à-vis China. It has arguably remained the single largest defining factor in shaping the Asia's economic and political destiny in the 20th century. The outcome of the WW2 and subsequent developments in East and South East Asia has made Japan to remain dependent on the US till today. The economic rise of China has mostly remained peaceful as it did not try to challenge the existing regional order. But now an increasing assertive China is posing question to both regional as well as to the global order. In this changed context both Japan and China have to sort out an alternative way so that the rise of China and security of Japan are not threatened. But much will depend on the goodwill of the US if it tries to make grand coalition of Asian countries to resist the Chinese dominance of the regional order, keeping Japan as the alternative gravity center. To that grand desire, US may try to lead it from the front for a while but will bring other countries behind Japan in the near future to maintain the status quo. Without much thinking, this will not be appreciated by China and a path of collision could be a foregone conclusion. A departure from this tentative scenario may happen if only Japan and China both understand their strategic path to avoid the confrontation. To that goal, Japan may have to negotiate alternative relationships with China, keeping US on the board while China has to decide Japanese dignified position in its own vision of regional and global order. Both sides have to communicate this goal in a creative way so that their economic complementarity and interdependence brings the desired prosperity to both the nations.

E. Counter-measures by China against any Unfavorable Development

From various recent moves by China, it may be easy to predict that any economic, political and military move taken by any outside power that may go against its interest in its immediate periphery or region is unlikely to go unchallenged. If it shows assertiveness to establish its desired order, then peace and stability in this region are likely to be affected. The creation of Asian Infrastructure Investment Bank (AIIB) looks to be first multilateral initiative to reduce the economic importance of Asian Development Bank (led by Japan) in particular and World Bank (led by the USA) in general. The success of Chinese company's bidding to construct a high-speed rail line in Jakarta in 2015, the failure to Japan to clinch the Australian submarine deal in 2016 are some of the examples that show the increasing role of Chinese hard and soft power in the dealing with international affairs.

6. But China and Japan Need Each Other

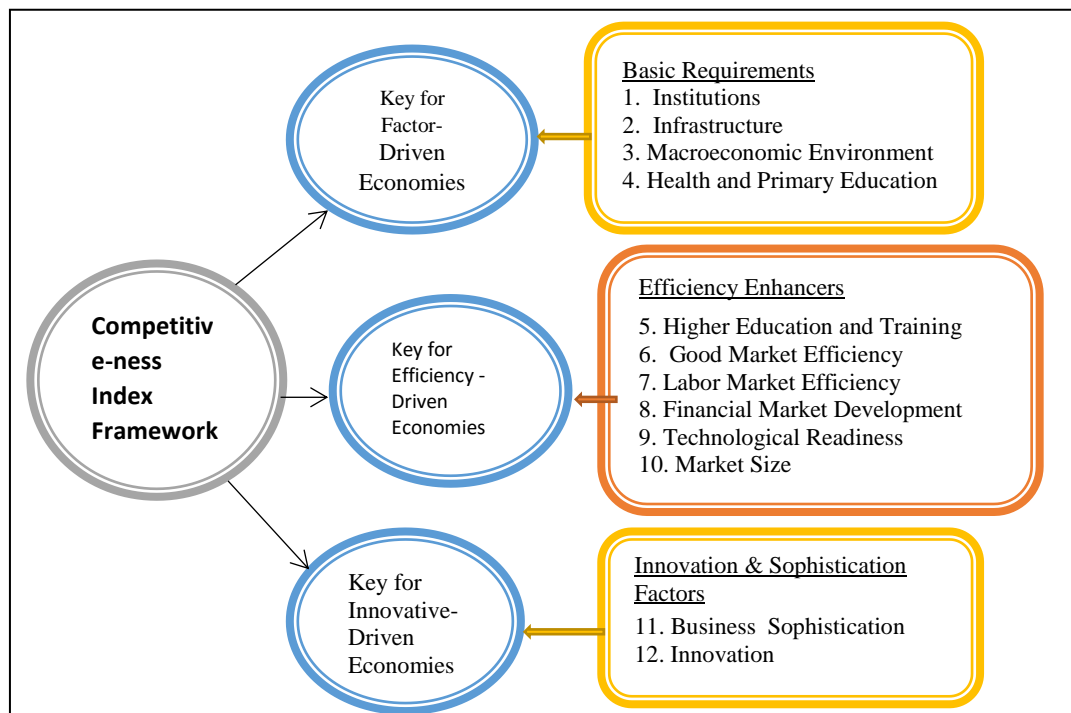
The point the paper wants to make is the any move to debase the economic relationship between these two Asian economic giants would be mutually costly. This conclusion is drawn on the basis of the following factors which have remained so far valid.

- Present economic relationship between Japan and China is one of the biggest in the world. Till now Chinese market is the single largest market for Japan and any immediate single replacement is not in the sight. On the other hand, the TPP is not going to make same sort of space to the Japanese producers. Undoubtedly, Japan is increasing its economic interactions with some of the ASEAN economies, but it will take time to reach the level of economic relationship that has been developed with China for last three decades.
- India could have foot the Japanese bill as a replacement in the medium term and many companies are viewing India as an attractive investment destination. But the cultural constraint will make the process difficult and time-consuming.

Though politically both of them are democratic states, culturally India and Japan diverge widely and sometimes the differences look to be unbridgeable. It will be easier for Japan to be drawn closer to India politically but they may never be comfortable ally on the economic front. Moreover, India can be equally attractive for the Chinese MNCs if India and China can maintain a viable political relationship between them.

- Both of them modeled their development led by exports. Japanese policy makers have never come out of that export-led mentality. There are many factors for nourishing that believe and a declining population base is not helping the cause of a consumption orientation of the economy. For any reversal of Japanese investment back home to deplete the holes of hollowing out of manufacturing base becomes non-viable by the demographic measure.

Figure 2: The Global Competitiveness Index Framework



Source: Adopted. World Economic Forum, GCR 2013-14

- The complementary nature of their development relationship. China has achieved an economic development phase which is considered to have reached

efficiency driven competitiveness. Japan, on the other hand, has already become an innovative driven economy. Given the deeper level of industrial interaction, China has a lot to gain from the industrial cooperation with Japan for its graduation to an innovation driven economy. This is an immediate relation that may not be substituted by any other economy in the world, not even by the German one.

- China is leading a drive to improve its environment by limiting the emission of industrial pollution. So shifting to clean industrial technologies has become a top priorities and Japan could become a natural partner as it has evolved into present level of non-polluting industrial development by having a similar experience of the past. Thus, they need each other as the geo-economic potential of the economic relationship is enormous (Drysdale, 2015).

7. Conclusion

The study indicates the bilateral economic engagement has proven to be beneficial to both the countries as the relationship. Given the different levels of industrial and technological capabilities, they have still remained deeply complementary. That gives the further space for economic engagement for both of them. Not only that, the economic relationship between these economic giants evolved and spread into a shape in a region where trade, investment, and production networks have integrated the countries deeply. This has given the economic interdependence between Japan and China another dimension. For Japan, the relationship carries further meaning in the sense that much of its investment in Southeast Asian countries depends on assembly and value add in China.

But the study somehow also brings an impression that, in the overall economic interaction process, Japanese dependency on China has gone into much deeper level, particularly in trade and even in investment. China in recent years has coming up very quickly as a net investor abroad. In that way it has been able to

spread its economic web wider which is bound to affect its economic and political clout in the world. Trade-wise also, more and more countries are gaining relative weight with China, thus helping to reduce the relative importance of Japan.

Nevertheless, some developments show a sort of economic delinking between them as well. At the same time, the political and military differences are increasing between them. These do not bode well in the context that due to political and military assertiveness from both the side and an increasing Chinese mood to contest and change the status quo of regional order in particular.

However, with periodic ups and downs in the political relationship, Japan and China have been so far able to maintain an interdependent economic relationship that has benefited them for more than three decades. So, they should try to avoid conflict as they need each other for their mutual economic advantages.

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