CHINA AND JAPAN: WILL POLITICAL TENSIONS CONSTRAIN ECONOMIC COOPERATION?

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EAI Background Brief No. 613

Date of Publication: 1 April 2011

Executive Summary

1. The year 2010 was perhaps the most difficult year for China's international relations. Various signs show that Tokyo has felt the pressure of China's assertiveness and has begun to take precautionary actions in response.

2. Despite weak political relations, the economic interdependence between these two countries is deepening. Japan is likely to rely more on China for its economic recovery from the global financial crisis and the recent earthquake. China on the other hand needs Japan's market, capital and advanced technology for its economic upgrading and sustainable growth.

3. China has cemented its status as Japan's biggest economic trade partner and is broadening the relationship. Weak demand from the United States. and other Western countries has led Japan to increasingly rely on China's market.

4. China is equally reliant on the Japanese economy. Due to its rapidly growing market and the Chinese government's economic stimulus policies in 2009, China imports everything from cars to high-tech electronics from Japan.

5. Although after 2005, Japan's foreign direct investment (FDI) in China experienced a new adjustment period, China is still one of the main recipients of Japan's FDI. Manufacturing sectors in China like transportation equipment, machinery and chemicals, as well as financial services, insurance and business services, are still dominated by Japan's FDI.

6. Recent years have also witnessed China's increasing FDI in Japan as Beijing became an important source of global FDI outflows. China's FDI in Japan concentrates on the non-manufacturing sectors such as food, retail, business services, and computer software outsourcing.

7. Although economic ties continue to be strong and has a binding effect on the two countries, the political and security differences between China and Japan have made the bilateral relations vulnerable to conflicts.

8. It is necessary for Tokyo to understand that China has no intention of confronting Japan or its allies. Maintaining stable relations with other major powers and penetrating their markets and attracting FDI for economic development have always been the main consideration of Beijing.

9. China and Japan have growing common interests in terms of bilateral relations as well as regional cooperation. Beijing understands that a closer partnership with Japan would not only guarantee the two economies' sustainable growth, but also promote peace and stability in the Asia-Pacific region and beyond.

10. The two countries also share common interests on a number of global issues, such as environmental degradation and energy security, and are committed to dealing with climate change.

11. As China and Japan adjust the focus of their cooperation and strengthen economic ties, they are likely to strive to reduce political disputes while making their economies more integrated.