

**CHINA-JAPAN ECONOMIC
INTERDEPENDENCY
DESPITE POLITICAL ANTAGONISM**

CHIANG Min-Hua

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Executive Summary

1. China-Japan economic ties have gone from strength to strength since the establishment of diplomatic relations in 1972. China's economy benefitted from Japan's investment and Japan's economic engagement with China was an energiser for its stagnant growth.
2. While Japan continued to supply capital goods and key components to China, China's exports to Japan have evolved along with its economic development, from energy resources in the 1980s to light manufactured goods (eg: textiles) in the 1990s and to heavy industrial goods (eg: machinery and electrical machinery) after the 2000s.
3. The investment-driven trade development has suffered a setback in recent years. Japan's investment in China declined from the peak in 2012 (US\$13.5 billion) to between US\$8.6 billion and US\$10.9 billion annually during the 2013-2016 period. In line with the investment dip, Japan's exports to and imports from China have also dipped since 2012 and 2013, respectively.
4. Japan Bank's survey in 2013 showed that China's rising labour cost (33%), intense business competition (25%), economic slowdown (24%) and worsening Sino-Japanese political relations (17%) are the most serious concerns for Japanese firms operating in China.
5. Apart from weak global demand and investment shift to ASEAN countries, Japanese firms' growing local procurement in China is a factor for Japan's falling exports to China. According to Japan External Trade Organisation's (JETRO) survey in 2016, 68% of Japanese companies in China procured local raw materials and industrial parts, up from 43% in 2001.
6. Japanese firms have established manufacturing alliance with local Chinese firms. The same survey exhibited that local Chinese companies are the largest source of procurement, accounting for 59% of total responses, followed by 35% procured from Japanese affiliates and 6% from other foreign affiliates in China.

7. With China's move towards a more consumption-based economy, the importance of manufacturing in Japan's investment in China declined from 78% in 2006 to 60% in 2014. During the same period, the shares of services in Japan's total investment in China increased from 24% to 39% with the wholesale and retail sectors as the main investment targets.
8. China is now a key source of inbound tourism and an emerging investor for Japan. Nonetheless, China's emerging power has posed challenges to Japan's role in directing regional economic integration.
9. Despite the continual political tension, JETRO's survey demonstrated that most Japanese firms still consider China the most important export market and a key investment destination. The direction of China's economic development will remain essential to the development of Sino-Japanese economic relations in the foreseeable future.