

Getting down to business on Japan–China relations

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When considering the state of Japan–China relations, much attention has been paid to fluctuations in the bilateral economic relationship. Given the political insecurities of East Asia — with tensions on the Korean peninsula, ambiguous US policy intentions and the Senkaku Islands territorial dispute — it is timely to take a look at how business relations between the two nations are faring.



On the one hand, there are signs that the [economic relationship](#) ^[1] between the two countries could [further](#) ^[2] improve. In commemoration of the 45th anniversary of normalisation of ties and the 40th anniversary of the signing of the Treaty of Peace and Friendship between Japan and China, in April 2017 the Japan Business Federation and the Japan-China Friendship Association, among others, established an ‘Exchange Promotion Executive Committee’. It is anticipated that the Committee will promote greater economic ties between the two countries and improve the business performance of Japanese corporations already operating in China.

As of October 2016, there were 32,313 Japanese firms operating in China. This is half of the 71,820 total Japanese firms that have expanded overseas, and far exceeds that of the United States, which has the second largest number of foreign firms in China at 8422. Approximately 80 per cent of Japanese firms in China have reported that they are making a profit, with 25.8 per cent stating that they are [more profitable in China](#) ^[3] than in Japan.

On the other hand, Japanese investment in China is showing signs of cooling down. Though internal reserves of Japanese companies are at an all-time high and there is heightened interest in where these funds will be allocated, new investment to China — which in the past has seen a

number of boom periods — peaked between 2011–12 and has since taken a downward trend.

Japanese companies have not overlooked the Chinese economic slowdown. As a result of the end of its demographic dividend and stagnating productivity levels, China is facing an increase in capital spending as a portion of GDP, decreasing efficiency, rising labour costs and decreasing returns on investment. Amid this situation, Japanese firms must decide whether it is wiser to remain in or withdraw from the Chinese market.

Companies that have performed well are deciding to maintain or even further expand their presence in China over the next year or two. According to a [survey](#) ^[4] by the Japan External Trade Organization, the number of firms responding that they would expand their operations in China increased by 2 per cent over the previous survey to 40.1 per cent, while 52.8 per cent said they would maintain their current presence.

At the same time, the number of firms that have said they would reduce their presence, transfer to a third country or withdraw from current local markets has also increased, to 7.1 per cent.

These diverging trends reflect how well Japanese companies have been able to adapt to the Chinese market. Many companies are dealing flexibly with the shifting economic trends in China and steadily improving their performance. But other companies that were unable to deal with China's economic climate or policy movements have performed poorly and withdrawn.

While [political tensions](#) ^[5] between Japan and China are a source of fragility for the bilateral relationship, the current movements on the economic front are by no means the result of political factors.

While there are tensions between Japan and China, political relations have been somewhat stable. Since the APEC meeting in November 2014, summit meetings and foreign ministerial meetings between Japan and China have been held every year.

One of the biggest sources of tension between Japan and China concerns the Senkaku Islands. Three times per month, four Chinese public vessels enter waters surrounding the Senkaku Islands for approximately two hours each, and every time this happens, Japan lodges protests. However, this 'three-four-two' formula remains consistent, and the dispute regarding territorial waters is to some extent being kept under control. Against this backdrop, among companies that responded that they would withdraw from or reduce their presence in the Chinese market, only 9 per cent cited China's political management. The decrease in revenue and increase in cost in the Chinese market is what is governing the decision by Japanese companies to withdraw from China.

In sum, the future success of Japan–China business relations is largely dependent on the direction of the Chinese economy, if the current stable bilateral political relationship continues.

A new trend that could reinvigorate the relationship is cross-border ecommerce, which has major potential in terms of scale and future growth. According to a market survey conducted by Japan's Ministry of Economy, Trade and Industry (METI), the size of China's ecommerce

market in 2016 in terms of purchases from Japan was 1.036 trillion yen, an increase over the previous year of 30.3 per cent. METI estimates that the ecommerce market will continue to grow strongly, from 1.337 trillion yen in 2017 to 1.905 trillion yen in 2020.

If Japanese companies can harness the strength of emerging sources of cross-border economic growth, such as ecommerce, the bilateral business relationship can continue to flourish and will be better equipped to weather any future political or economic storms.

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[1] economic relationship:

<http://www.eastasiaforum.org/2017/07/09/trump-threat-drives-japan-and-china-closer/>

[2] further:

<http://www.eastasiaforum.org/2017/07/10/japan-opens-the-way-to-cooperation-on-chinas-belt-and-road-initiative/>

[3] more profitable in China:

<http://www.eastasiaforum.org/2017/05/16/japanese-companies-need-to-open-up-or-shut-down/>

[4] survey:

https://www.jetro.go.jp/ext_images/en/reports/survey/pdf/rp_firms_asia_oceania2016.pdf

[5] political tensions:

<http://www.eastasiaforum.org/2017/05/06/japan-taiwan-relations-under-beijings-watchful-eye/>