

Commercial self-interest a politic course

Japan's corporations need détente to work in China, writes Shiro Armstrong

Chinese Premier Wen Jiabao flies into Tokyo this morning for talks with his Japanese counterpart, Shinzo Abe, in a continuing effort to ease simmering politics between two giant neighbours in Asia with a booming economic relationship.

Getting relations with East Asia (read China) sorted out was an issue in the contest for succession in Japan after Koizumi's prime ministership. Koizumi's visits to Yasukuni shrine de-railed them. There had been no bilateral leadership meetings in the previous six years. Abe's first visit abroad was to China. China has been playing its part in getting things back on course, with unusual moderation on the awkward comfort women issue being played out in Japan, an issue that arose in the US Congress.

Sensitivities in the political relationship affect some aspects of Japan's economic relationship with China more than others. Many large Japanese companies believe they are global brands and can de-link their business in China from their country of national origin. The boycotts that occurred in 2005, did not significantly affect their sales or investment decisions. Indeed, Japanese business surveys of the investment and business environment in China suggest that a *hot* economic relationship is thought by business to be compatible with a *cold* political relationship. Japanese auto makers, for example, have to be 50 per cent Chinese owned and this limits negative sentiment when the going gets tough.

But high political relations are important infrastructure for bilateral dealings that involve government, and many do. Few in Japan feel that Japan's bid for the prestigious fast rail contract, the fastest train within the fast rail project between Beijing and Shanghai, was not affected by politics. Japan will still produce high speed trains for the Beijing-Shanghai rail link but France won the prime contract. And large Japanese companies in China have trouble representing their interests to Chinese officials, an area where US and European firms have an advantage.

China's policy-making remains a top down process, though this is changing. Japan's lack of access to top level policy makers in China hurts Japanese business. From a Chinese perspective, the lack of an organised, direct and systematic Japanese voice is missing. The investment climate in China is important for both countries. Absence of a framework within which to settle differences and to gauge policy direction and intention impedes investment flows. Limited policy transparency in China is cited as one of the biggest impediments to Japanese business in China and high level policy dialogue would help alleviate this.

China's accession to the WTO in 2001 marked an important turning point in China's integration into the world economy. The recognition by industrial countries of the new legal status of trading with China not only provided more security for China in international markets but also for foreign business in Chinese markets. Japan now competes with other industrial countries in a much more open Chinese market so it can ill-afford to carry political baggage into this economic contest.

Japan is pursuing the idea of an Economic Partnership Agreement (EPA) with China. This includes a Free Trade Agreement on goods trade. Both sides concede this is a long term goal but its consideration could get them talking and moving in the same direction. Investment would be covered under an EPA. Japanese foreign direct investment in China has helped Japanese firms stay competitive globally, and has helped lift China towards the international technology frontier through Japanese technology transfer. The nature of Japanese investment in China is changing. Previously most investment was aimed at building assembly plants to export to third country markets. The growing domestic market has made domestic sales a primary target for Japanese companies. Most of the high value added activities (design, advertising and research) are still undertaken in Japan.

These developments and others, in the areas of energy cooperation, financial market development and international policy cooperation, as well as the fact that China is already

Japan's largest export market, give added priority in Japan to the economic relationship with China and a powerful rationale for containing the bilateral political sensitivities that might be-devil delivering its large potential.

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