

# PERSPECTIVE

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## **The COVID-19 Pandemic Complicates Japan-China Relations: Will This Benefit ASEAN?**

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### **EXECUTIVE SUMMARY**

- Due to China's coronavirus lockdown, Japan's imports from China in February 2020 fell by almost half from a year earlier. This disrupted the flow of parts to Japanese factories and goods to Japanese retail malls, which sharply affected Japan's exports, GDP, and consumer welfare.
- The \$2.2 billion fund announced on 7 April has a narrow and limited intention to restore production of critically needed goods such as medical masks, help Japanese firms seeking to relocate outside China, and mitigate accumulating supply chain risk in China which Japanese firms had been ignoring.
- This move initially appeared to be only a minor setback to warming Sino-Japanese relations.
- However, far-reaching consequences of the coronavirus pandemic have caused adjustments to Japan's perceptions and foreign relations in such a way as to make this move part of an overall setback in Japan-China relations.
- Japan's post-pandemic foreign policy outlook may create new opportunities for ASEAN-Japan cooperation.

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## **INTRODUCTION**

In early April 2020 as the coronavirus pandemic sharply curtailed Japan's supply of intermediate and finished goods produced by supply chains anchored in China, Japan earmarked ¥220 billion of its emergency economic support package to help Japanese manufacturers shift production of critically needed goods from China to Japan and another ¥23.5 billion to move production to third countries. The first package of subsidies announced on 17 July included 87 companies receiving a total of JPY70 billion (\$653 million). Thirty firms will relocate production to Southeast Asia and the remaining 57 will return production to Japan.<sup>1</sup>

This move had been discussed and approved in principle at the 5 March 2020 meeting of the Council on Investments for the Future.<sup>2</sup> At this meeting, Prime Minister Shinzo Abe said, "for those products with high added value and for which we are highly dependent on a single country, we intend to relocate the production bases to Japan. Regarding products that do not fall into this category, we aim to avoid relying on a single country and diversify production bases across a number of countries, including those of the Association of Southeast Asian Nations."

## **A LIMITED MOVE TO DE-RISK JAPAN'S CHINA-CENTRED SUPPLY CHAINS**

The concern of the Council on Investments for the Future was narrowly focused on dealing with unforeseen difficulties created by the coronavirus pandemic for Japanese business and society. Global supply chain risk materialized in the losses to the Japanese economy caused by China's coronavirus lockdown, which disrupted Japanese supply chains in China and caused a shortage of critically needed medicines and protective medical gear sourced from China, highlighting the overdependence on China.

Leaving aside the sudden impact of the coronavirus, which led to a nationwide lockdown that caused as many as 205 million Chinese jobs being lost,<sup>3</sup> there were already other longer-term economic risks facing Japanese firms in China. These included reduced exports due to the US-China trade war and slowing global GDP and trade growth, which put at greater risk a Chinese economy overburdened by debt. At the same time, the cost of production in China was rising due to higher wage demands and tightening environmental regulation.

Until the pandemic hit, Japanese firms operating supply chains in China were uncertain about what to expect and took a wait-and-see attitude. But by February 2020, prospects for the Phase One trade deal signed with the United States in January were already in doubt when the pandemic's enormous negative impact became apparent. A February survey of 2,600 Japanese firms in China found that 37 percent were looking outside China for suppliers.<sup>4</sup> A Japan Chamber of Commerce and Industry survey published in April found that of 8,852 Japanese firms in China, 7.1 percent wanted to scale down or withdraw.<sup>5</sup>

Nevertheless, Abe's \$2.2 billion initiative by no means meant that corporate Japan had an intention to de-couple from the Chinese economy. The above-mentioned survey also found that 40.1 percent of Japanese firms were willing to expand their Chinese operations. China had become Japan's largest trade partner, and Japanese investment in China no longer used it primarily as an export platform. Most Japanese firms were now geared to serve China's

growing need for industrial and consumer goods especially in areas like software, telecoms, wholesale and food. According to the Japanese government, the average proportion of Japanese factory production in China that was sold as exports in 2019 was only 32.5 percent (JETRO).<sup>6</sup> And as Chinese consumers gained disposable income, Japanese retailers and service industries stood to join Japanese manufacturers doing good business in China. But reconciling corporate Japan's interests with Japan's broader geopolitical and political interests in an era of rising strategic tension is proving to be a vexing issue.

## **IMPACT ON THE BROADER BILATERAL RELATIONSHIP**

Abe did not wish his supply chain initiative, which targeted Japan's export-oriented investment in China to affect a hoped-for bilateral political rapprochement that began in May 2018 when prime minister Li Keqiang visited Tokyo. The US-China trade war had begun in March and Li visited Tokyo in May to entice Japan with new trade and investment opportunities as China's economic relationship with the United States soured. Li was received cordially by Prime Minister Shinzo Abe, who was keen to calm Japan's territorial conflict with China; establish strategic stability and cooperation; expand access to the growing Chinese economy; partner with China to promote regional stability and prosperity (within the framework of the US-Japan alliance); and develop a sound political relationship. Li invited Abe to visit Beijing to discuss a normalization of bilateral relations.<sup>7</sup>

Japan has relied on positive economic engagement with China to cultivate friendship and enhance mutually beneficial relations. But the resulting bilateral relationship is narrowly based on China's need for Japanese capital, goods, and technology, which is diminishing over time as China works to eliminate dependence on the advanced western economies. Meanwhile, China's political and strategic animosity directed against Japan due to historical grievances and Japan's alliance with the United States continues unabated as evidenced by increasing military manoeuvring in and around the Japanese islands.<sup>8</sup>

### *A 'new era' of bilateral collaboration?*

Abe visited Beijing in October 2018 where he met President Xi Jinping and offered him a state visit to Japan. Abe vowed to work for a "new era" of "collaboration not competition" in bilateral ties that was to be inaugurated by agreements signed during Xi Jinping's visit to Tokyo in April 2020.<sup>9</sup> Abe also "raised pending problems directly with President Xi," a reference to Japanese citizens recently arrested for espionage in China as well as continuing intrusions by Chinese vessels into waters surrounding the Senkaku/Diaoyu Islands.<sup>10</sup>

After returning to Tokyo, Abe was eager to make the impending Xi state visit a success and ignored escalating Chinese intrusions into waters immediately surrounding the Senkaku/Diaoyu Islands. Japan's coast guard reported that from January to mid-December 2019, Chinese government vessels intruded 1,021 times—far exceeding the previous record of 819 set in 2013—and entered the Japanese-administered islands territorial waters a record-setting 112 times.<sup>11</sup> To register this rising geopolitical risk, Japanese Defense Minister Taro Kono said that Japan "cannot overlook" the frequent violations of Japanese territorial waters, and that China needed to "work hard" to improve the situation "otherwise we may find a difficult environment for the visit".<sup>12</sup>

To curry favour with China, Abe continued to allow visitors from China (except those originating in Wuhan) to enter Japan without quarantine restrictions after China began lockdown measures on 23 January. This policy elicited mounting domestic criticism for the risk this posed to public health in Japan. Despite calls as early as February 2020 by his own Liberal Democratic Party's members and by opposition parties (including the Japanese Communist Party) to postpone Xi's visit due to the coronavirus, Abe remained optimistic about Xi's state visit.<sup>13</sup>

Abe's attitude was also out of step with changing Japanese perceptions of China. According to the 2019 Genron poll on mutual public perceptions, Japanese opinion toward China deteriorated with 44.8 percent saying relations were "bad", a six percent increase from 2018; 31.8 percent thought that relations had gotten worse, an increase of 13 percent. Overall, 84.7 percent had an "unfavourable" impression of China; only 15 percent had a "favorable" impression.<sup>14</sup>

Abe's effort to curry China's favour despite mounting problems, continued until 5 March 2020 when Japan announced a trifecta of China-related initiatives. The government announced a delay in Xi's visit due to the coronavirus pandemic. It also announced that a 14-day quarantine for all visitors from China would now be required. Finally, as discussed above, Abe announced subsidies to help Japanese firms relocate supply chains out of China.

Yet another economic de-risking move that was perceived to distance China and Japan happened on 11 May, when a new law was passed to require advance notice from foreign investors that wanted more than a one percent stake in designated Japanese firms, which included over half of Japan's listed companies.<sup>15</sup> The intent was to limit foreign acquisitions of strategically significant Japanese firms that became distressed or undervalued due to the economic fallout of the pandemic. It did not specifically target China, but efforts by Chinese state-owned and state-backed enterprises and investment funds to acquire ownership in strategically important Japanese firms would likely be affected by it.

## **XI VISIT EVENTUALLY DERAILED AND A "NEW ERA" POSTPONED**

From March into April 2020, the world responded politically to China's flawed early handling of the coronavirus and its use of the World Health Organization (WHO) to manage perceptions during the global spread of the disease. WHO came under widespread criticism including in Japan where Deputy Prime Minister Taro Aso said that it should be called the "Chinese Health Organization".<sup>16</sup> In May, China's reliance on "wolf warrior" diplomacy to create a praiseworthy image of Beijing's role during the pandemic led the Japan Times on 26 May to publish an op-ed entitled, 'China is its own worst enemy.'<sup>17</sup> Then on 28 May, China's National People's Congress called on its Standing Committee to draft national security legislation for Hong Kong that would "outlaw acts of secession, subversion, terrorism and conspiracy with external forces in Hong Kong," and would allow mainland security agencies to operate as necessary to enforce the law.<sup>18</sup> The next day, two LDP policy forums devoted to foreign affairs sent letters to Abe asking him to cancel Xi's visit and resist China's proposed national security legislation for Hong Kong.<sup>19</sup>

Geopolitically, the focus was also on China as it moved aggressively around its contested South Asian and East Asian peripheries. China sank a Vietnamese fishing vessel on 8 April; operated an ocean survey vessel from mid-April to mid-May inside Malaysia's EEZ; on 18-

19 April, it claimed the Paracel and Spratly islands as administrative districts and named some 80 contested land features in the Spratly Islands. Along the Sino-Indian border, Indian and Chinese soldiers engaged in physical fighting in Ladakh on 5 May and 9 May, which culminated in extended hand-to-hand combat on 15 June that led to the death of 20 Indian troops. On 10 May, two Chinese coast guard ships entered Japanese-administered territorial waters of the Senkaku (Diaoyu) Islands and ordered a Japanese fishing vessel to leave the area.<sup>20</sup> In mid-May, China began large-scale naval military exercises that reportedly will involve both of China's aircraft carriers and include a simulated takeover of Taiwan-administered Pratas Island.<sup>21</sup> And on 29 May, Li Zuocheng, chief of the Joint Staff Department and member of the Central Military Commission, said that China would "take all necessary steps to resolutely smash any separatist plots or actions" in Taiwan.<sup>22</sup>

On 4 June, a date pregnant with meaning for those engaged with China, the Japanese government reported that it had ceased preparations for Xi's state visit.<sup>23</sup> Then days later, on 10 June, Abe announced that, in light of the need to uphold democracy and human rights as well as lead global opinion, he would draft a statement to be issued by the G-7 nations asking China to reconsider its proposed Hong Kong national security legislation.<sup>24</sup> The G7 issued the statement on 17 June, which expressed "grave concern regarding China's decision to impose a national security law on Hong Kong" because it "would curtail and threaten the fundamental rights and freedoms of all the population protected by the rule of law and the existence of an independent justice system".<sup>25</sup> With over 1,400 Japanese firms operating in Hong Kong, Japan also has a substantial economic stake in preserving the status quo there.

On 30 June, the day that China's Standing Committee of the National People's Congress passed the National Security Law for Hong Kong, Japanese Defense Minister Taro Kono warned China that "it will significantly affect President Xi Jinping's state visit to Japan," preparations for which had been suspended although the trip itself had not been officially called off.<sup>26</sup>

Abe likely was reluctant to voice criticisms that China would almost certainly view as insults. But political and geopolitical developments concerning China greatly changed the domestic and international political atmosphere to make it difficult for Abe to sustain his attempted bilateral rapprochement with China.

Unfortunately, as desirable and beneficial to both sides as better bilateral relations may be, the Japan-China relationship is entangled with wider economic, political, and social circumstances that condition Japan's economic engagement with China. Japan and China are discovering that, despite their best efforts, deepening their bilateral economic engagement is difficult to realize in a world of worsening geopolitical, ideological, economic, and societal divisions.

## **IMPLICATIONS FOR SOUTHEAST ASIA**

As Japan becomes more proactive in looking for ways to reduce overdependence on the Chinese economy and maintain the status quo in regional and global governance, it will naturally look to enhance engagement and cooperation with ASEAN members that share these concerns. Certainly, with respect to supply chain diversification out of China, Japan can be expected to look favourably upon ASEAN member plans to join the Comprehensive

and Progressive Agreement for Trans-Pacific Partnership (CPTPP) or to initiate infrastructure investment-focused ASEAN-Japan discussions to enhance ASEAN's attractiveness as an integrated platform for Indo-Pacific supply chains.

In the area of maritime security and regional governance under the rules-based order, Japan undoubtedly welcomed the Chairman's Statement of the 36<sup>th</sup> ASEAN Summit held in late June, which reaffirmed ASEAN's commitment to "the peaceful resolution of disputes, including full respect for legal and diplomatic processes, without resorting to the threat or use of force, in accordance with the universally recognised principles of international law, including the 1982 United Nations Convention on the Law of the Sea (UNCLOS);" and, "stressed the importance of maintaining and promoting peace, security, stability, safety and freedom of navigation in and overflight above the South China Sea." It would be in Japan's interest to support and enhance ASEAN leadership in these areas.

Finally, in the post-COVID-19 world, enhanced ASEAN-Japan non-traditional security cooperation to prevent and manage future epidemics could and should be an important new initiative.

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<sup>1</sup> "Japan reveals 87 projects eligible for 'China exit' subsidies." Nikkei Asian Review, 17 July 2020, at <https://asia.nikkei.com/Economy/Japan-reveals-87-projects-eligible-for-China-exit-subsidies>.

<sup>2</sup> "Council on investments for the future." The Prime Minister in Action, Cabinet Office of Japan, 5 March 2020, at [https://japan.kantei.go.jp/98\\_abe/actions/202003/00009.html](https://japan.kantei.go.jp/98_abe/actions/202003/00009.html).

<sup>3</sup> "Coronavirus: China's unemployment crisis mounts, but nobody knows true number of jobless." South China Morning Post, 3 April 2020, at <https://www.scmp.com/economy/china-economy/article/3078251/coronavirus-chinas-unemployment-crisis-mounts-nobody-knows>.

<sup>4</sup> "Japan sets aside ¥243.5 billion to help firms shift production out of China." 9 April 2020, at <https://www.japantimes.co.jp/news/2020/04/09/business/japan-sets-aside-%C2%A5243-5-billion-help-firms-shift-production-china/>.

<sup>5</sup> "Japan to Fund Firms to Shift Production Out of China." Bloomberg, 8 April 2020, at <https://www.bloomberg.com/news/articles/2020-04-08/japan-to-fund-firms-to-shift-production-out-of-china>.

<sup>6</sup> *Results of JETRO's 2019 Survey on Business Conditions of Japanese Companies in Asia and Oceania*. Japan External Trade Organization (JETRO). 13 February 2020, at <https://www.jetro.go.jp/en/news/releases/2020/c615b3d1e5683443.html>.

<sup>7</sup> "China, Japan mark 40th anniversary of peace and friendship treaty." South China Morning Post, 12 August 2020, at <https://www.scmp.com/news/china/diplomacy-defence/article/2159368/china-japan-mark-40th-anniversary-peace-and-friendship>.

<sup>8</sup> Japan Ministry of Defense White Paper 2019, pp. 71-74, at [https://www.mod.go.jp/e/publ/w\\_paper/2019.html](https://www.mod.go.jp/e/publ/w_paper/2019.html).

<sup>9</sup> "Japan, China vow to promote new economic cooperation amid trade war." Kyodo News, 27 October 2018, at <https://english.kyodonews.net/news/2018/10/646e04aecb99-update2-japan-china-agree-to-boost-economic-cooperation-amid-trade-war.html>.

<sup>10</sup> "Japan's once-a-decade mind games with China over top leader visit." Nikkei Asian Review, 27 January 2020, at <https://asia.nikkei.com/Politics/Inside-Japanese-politics/Japan-s-once-a-decade-mind-games-with-China-over-top-leader-visit>.

<sup>11</sup> "Ahead of Xi's visit, Japan troubled by Senkaku incursions." Nikkei Asian Review, 13 December 2019, at <https://asia.nikkei.com/Politics/International-relations/Ahead-of-Xi-s-visit-Japan-troubled-by-Senkaku-incursions>.

<sup>12</sup> "Japanese defence chief Taro Kono warns China over disputed islands: respect international norms or 'pay the cost.'" South China Morning Post, 15 January 2020, at:

<https://www.scmp.com/news/asia/east-asia/article/3046109/japans-taro-kono-warns-china-adhere-international-norms-or-pay>.

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<sup>13</sup> “Calls grow to postpone Xi’s April visit to Japan.” Asia News Network, 17 February 2020, at <https://asianews.network/2020/02/17/calls-grow-to-postpone-xis-april-visit-to-japan/>.

<sup>14</sup> *The Japan-China Joint Opinion Survey 2019*. Genron, 24 October 2019, at [http://www.genron-ngo.net/en/opinion\\_polls/archives/5505.html](http://www.genron-ngo.net/en/opinion_polls/archives/5505.html).

<sup>15</sup> “Japan moves to limit foreign investment in half of listed firms.” Japan Times, 11 May 2020, at <https://www.japantimes.co.jp/news/2020/05/11/business/economy-business/japan-limit-foreign-investment-listed-firms/#.XvRAxygzaUk>.

<sup>16</sup> “Trump Slammed the W.H.O. Over Coronavirus. He’s Not Alone.” New York Times, 8 April 2020, at <https://www.nytimes.com/2020/04/08/world/asia/trump-who-coronavirus-china.html>.

<sup>17</sup> “China is its own worst enemy.” Japan Times, 26 May 2020, at <https://www.japantimes.co.jp/opinion/2020/05/26/commentary/world-commentary/china-worst-enemy/#.XvRafCgzaUk>.

<sup>18</sup> “Security law to aid confidence in Hong Kong.” China Daily, 28 May 2020, at <https://global.chinadaily.com.cn/a/202005/28/WS5ecefdc1a310a8b241158f77.html> and “Hong Kong Opens Door to China’s Hulking Security State.” New York Times, 2 July 2020, at <https://www.nytimes.com/2020/07/02/world/asia/hong-kong-security-china.html>.

<sup>19</sup> “Japan warns China's move on H.K. law would affect Xi's visit.” Kyodo News, 30 June 2020, at <https://english.kyodonews.net/news/2020/06/d57bf9341cd8-update1-japan-says-passage-of-chinas-security-law-for-hk-regrettable.html>.

<sup>20</sup> “Japan Protests China Coast Guard Harassment of Fishing Vessel Near Senkaku Islands.” The Diplomat, 11 May 2020, at <https://thediplomat.com/2020/05/japan-protests-china-coast-guard-harassment-of-fishing-vessel-near-senkaku-islands/>.

<sup>21</sup> “US, China tensions poised to erupt over Taiwan.” Asia Times, 28 May 2020, at <https://asiatimes.com/2020/05/us-china-tensions-poised-to-erupt-over-taiwan/>. This exercise took place on 1-5 July and involved a Type 071 landing helicopter dock amphibious assault ship. Nearby in the South China Sea, the US Navy put on a dual carrier exercise with a third US carrier patrolling in the Western Pacific. See also “China Launches Naval Exercise in South China Sea.” Radio Free Asia, 2 July 2020, at <https://www.bignewsnetwork.com/news/265641831/china-launches-naval-exercise-in-south-china-sea> and “Reagan, Nimitz Enter South China Sea as China Conducts its Own Military Exercises.” Military.com, 5 July 2020, at <https://www.military.com/daily-news/2020/07/05/two-us-aircraft-carriers-enter-south-china-sea-china-conducts-its-own-military-exercises.html>.

<sup>22</sup> “Chinese general threatens attack on Taiwan to stop independence,” Sydney Morning Herald, 29 May 2020, at <https://www.smh.com.au/world/asia/chinese-general-threatens-attack-on-taiwan-to-stop-independence-20200529-p54xux.html>.

<sup>23</sup> “Xi’s Japan trip unlikely this year as US-China tensions burn.” Nikkei Asian Review, 5 June 2020, at <https://asia.nikkei.com/Politics/Inside-Japanese-politics/Xi-s-Japan-trip-unlikely-this-year-as-US-China-tensions-burn>.

<sup>24</sup> “Japan PM Abe says G-7 nations eye joint statement on Hong Kong.” The Mainichi, 10 June 2020, at <https://mainichi.jp/english/articles/20200610/p2g/00m/0na/047000c>.

<sup>25</sup> G7 Foreign Ministers’ Statement on Hong Kong. 2020, at <https://www.state.gov/g7-foreign-ministers-statement-on-hong-kong/>.

<sup>26</sup> “Japan warns China's move on H.K. law would affect Xi's visit.” Kyodo News, 30 June 2020.

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