GLOBAL CHINA
ASSESSING CHINA'S GROWING ROLE IN THE WORLD

CHINA, JAPAN, AND THE ART OF ECONOMIC STATECRAFT

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EXECUTIVE SUMMARY

To some observers, Asia is moving towards a long familiar past — a China-centric regional order. While the jury is still out on the outcome of rekindled strategic rivalry between China and the United States (an extra-regional actor enjoying primacy during the past seven decades), most believe it is game over when it comes to Asian great power competition. The conclusion seems obvious to most: China has eclipsed Japan. However, a focus on economic statecraft renders this conclusion premature.

Geoeconomics stands to define Asia not only because a more powerful China is flexing its state-capitalism arm abroad, but also because Japan has overcome enough of its domestic limitations to offer economic leadership. Both China and Japan are pushing visions of regional integration (the Belt and Road Initiative and the Free and Open Indo-Pacific, respectively) and offering development finance to see them through, but neither is pressing developing Asia with binary choices. The regional order in Asia is contested, but not exclusionary.

In the 21st century, the task for Japan has been to exert influence with dwindling resources (official development assistance, ODA, budgets have been slashed for years) and avoid becoming a legacy power banking on the economic footprint built during its days of glory. For China, the major burst in material capabilities has purchased great influence, but significant challenges loom ahead in ensuring the long-term sustainability of Belt and Road projects and preventing a backlash in recipient countries out of concern with onerous lending terms and/or undue political influence.

Sino-Japanese relations are not defined exclusively by competition. Japan and China are both part of an emerging trade grouping (the Regional Comprehensive Economic Partnership Agreement, RCEP), and there is incipient cooperation on development finance. Growing uncertainty about the role of the United States created a powerful incentive for Asia's great powers to stabilize their relationship after years in deep disrepair.

The improvement of bilateral ties, however, is no prelude to a reordering of Asian geopolitics. There is no seismic change in security alignments at work. And some arenas of economic statecraft are likely to pose a harder edge for Sino-Japanese competition. China's bid to become a leader in and achieve greater self-sufficiency on frontier technologies such as artificial intelligence (AI), robotics, and smart manufacturing could redefine the terrain for Japan-China economic interdependence. Japan has deemed Chinese telecom firms such as Huawei and ZTE a cybersecurity risk bypassing them in 5G government contracts, and has recently tightened screening of foreign investments to prevent technological leakage. Economic security is fast becoming the new frontier of Asian power competition.

TRADING PLACES IN ASIA

To some observers, Asia is moving towards a long familiar past — a China-centric regional order. While the jury is still out on the outcome of rekindled strategic rivalry between China and the United States (an extra-regional actor enjoying primacy during the past seven decades), most believe it is game over when it comes to Asian great power competition. The conclusion seems obvious to most: China has eclipsed Japan.

The metrics of Japan's regional dethronement are not hard to come by. After decades of breakneck Chinese economic growth and a sluggish Japanese economy hampered by deflation, China overtook Japan in 2010 as the second-largest economy in the world. China has used this greater wealth to modernize its military, far surpassing Japan's defense expenditures which have hued closely to the self-imposed ceiling of 1% of GDP.

But China is also said to have eaten Tokyo's lunch when it comes to the jewel of its diplomacy: economic engagement. Although China only joined the World Trade Organization (WTO) in 2001, it has now become the largest trading partner for all Asian nations. It is China — not Japan — that is currently innovating with regional institutions — creating the Asian Infrastructure Investment Bank (AIIB) geared to alleviate a significant bottleneck to regional economic growth — and that has captured the world's attention with its bold connectivity agenda under the rubric of the Belt and Road Initiative (BRI). Finally, many believe China is more adept at translating economic largesse into political influence: it has availed itself of strategic assets (for example, the Hambantota port in Sri Lanka), has preempted concerted pushback by the Association of Southeast Asian Nations (ASEAN) on its expansive claims in the South China Sea by cultivating ties with individual members such as Cambodia, and has even undermined Western solidarity on the (de)merits of endorsing its signature foreign policy track — with European Union members such as Hungary, Poland, and Italy signing on to the BRI. In contrast, despite decades of aid giving to Asian countries, Japan was not able to build deep relations of trust with its neighbors in Northeast Asia, nor was it able to galvanize Southeast Asia in favor of its mid-2000s bid to become a permanent member of the U.N. Security Council — the pinnacle of success for its aspirations as a global civilian power.

In Asia, the future appears more Chinese than Japanese. This is a sharp reversal from the time when Japan catapulted from postwar devastation to join the ranks of industrialized nations, led the regional economy through trade and investment links into a flying-geese formation with developing Asia embracing export-led growth; and became a major source of capital and expertise for China to realize its growth ambitions.

SINO-JAPANESE RELATIONS: FROM ECONOMICS TO GEOECONOMICS

For close to a quarter century in the aftermath of World War II, there was little contact between Tokyo and Beijing. The deep wounds of Japan's war of aggression in the mainland, the success of the Communist revolution in China, and the rigid divides of a full-blown Cold War kept Japan and China apart. The normalization of relations had to wait for a historic shift for the United States, under President Richard Nixon, to seek the reestablishment of diplomatic relations with Communist China to counter the Soviet Union.[1] With Washington's greenlight, Japanese policymakers sprang into action, achieving normalization of relations six years ahead of the Americans (1972) with a Treaty of Peace and Friendship to follow a few years later (1978).

The promise of economic integration was at the heart of the reconstruction project for Sino-Japanese relations. Although China forsook reparation payments, many in Japan saw in official development assistance (ODA) a way to make amends for past misdeeds. And in Japan's model of economic engagement, official economic assistance was a precursor to private investment and trade links, which also grew over time. It should come as no surprise that aid giving (with China emerging as the largest recipient of Japanese ODA) became integral to bilateral relations, for both sides pinned on it sizable ambitions: for China to leapfrog its economic development; and for Japan to facilitate historical reconciliation, to open the untapped potential of a vast Chinese market, and to encourage a lasting Sino-Soviet split — a welcome development for Japan's security planners who saw in the Soviet Union the largest security threat to the homeland throughout the Cold War era.

If the West chose engagement to guide its relations with an opening China, Japan was its most ardent practitioner. In the aftermath of China's violent crackdown of the Tiananmen Square democracy movement in 1989, Japan took the rare step a year later of breaking ranks with the international donor community when it alone restarted ODA loans. Tokyo acted out of the conviction that economic carrots would work better to entice restraint from China's leadership. However, economic ties have never sufficed to ensure smooth sailing in Japan-China relations. In the 1990s, an uptick in China's nationalistic education and its lingering discontent over what it deemed was insufficient Japanese contrition (as evidenced in the textbook controversies) produced a palpable deterioration in bilateral ties.[2] In 1995, Tokyo suspended grant aid to China in the wake of nuclear testing that contravened Japan's non-proliferation goals. In the early 2000s, Prime Minister Junichiro Koizumi's annual visits to the Yasukuni Shrine — which commemorates the fallen soldier but also enshrines 14 convicted war criminals — precluded high-level political dialogue among both countries.[3] In 2005, large-scale anti-Japanese riots and boycotts erupted in Chinese cities. And the first half of the 2010s saw a nadir in bilateral relations. The dispute over the Senkaku Islands heated up with China's "gray zone" activities in the East China Sea becoming a major preoccupation for Japan's defense strategy.[4] History, territory, and security have all contrived to produce the pull-and-tug dynamic of postwar Sino-Japanese relations.

And yet despite the powerful structural forces that make for a rocky relationship amongst Asia's great powers, economic interdependence did not succumb to them. It is the uncanny ability to compartmentalize that came to define the bilateral relationship as captured by the well-known dictum "cold politics, hot economics." China remains Japan's largest trading partner, and Japan surpassed all foreign investors in China with cumulative investments of $101 billion dollars between 1995 and 2017.[5] But it is no longer sufficient to focus on the depth and resilience of bilateral economic ties. We have entered a new era where *both* China and Japan are using economic influence abroad to achieve larger political purposes; and where each actor is acting upon a distinct vision of the optimal economic and political architecture for Asia — finding little common ground on the desired role for the United States in the region's future.

While Japan and China have both ridden the coattails of globalization to rise as great economic powers tying their markets more closely together, they are increasingly adopting defensive measures, wary of the potential weaponization of economic interdependence.[6] China has doubled down on an interventionist industrial policy to achieve high-tech dominance and greater self-reliance; while Japan is tightening (Chinese) access to critical technologies and opting out of Chinese telecom offerings out of concern with cybersecurity risks. Economic statecraft — with purposive state action linking closely economic and security goals and leveraging material wealth to achieve influence abroad — is increasingly defining Sino-Japanese relations. Importantly, the Asian powers have been savvy enough to avoid rendering the geoeconomic match an all-or-nothing choice between competition and collaboration.

COMPETITIVE, BUT NOT EXCLUSIONARY REGIONALISM

Economic statecraft towards what end? How a risen China will shape the international order is undoubtedly the question of our time. Views in the United States have hardened, with less hope pinned on the notion of a responsible stakeholder and more credence given to the theory of a revisionist or revolutionary power. However, rather than an across-the-board buttressing or overhauling of the international order, China's impact has varied by issue area and by geographical space. China has sought greater influence within — rather than the demise of — the Bretton Woods institutions;[7] has been skeptical or has outright rejected institutions and norms that it perceives as constraining the projection of its national power (the U.S. alliance network, rule of law and freedom of navigation in the South China Sea, and the human rights regime);[8] and has used its status as creditor nation to recycle capital in Asia and beyond both to boost its own economy and gain influence overseas.[9] Development finance illustrates well the complexities of Chinese international behavior for it comprises both a multilateral track endorsing international standards and transparency (AIIB) and a bilateral one (BRI) with deliberate opacity on lending terms. China's views of Japan's place in its desired regional order are equally complex — both rival and partner — which Xiaoyu Pu attributes to the imperatives of domestic legitimacy: nationalism and economic growth.[10]

Japan's economic statecraft is attuned to this profound power shift. China's bid for regional primacy has posed two major problems for Japan: robbing it of its status as Asia's leading economy and calling into question the foundation of postwar Japanese security policy — the preeminence of the United States as its security guarantor and enforcer of a rules-based liberal order. Not surprisingly, Sino-Japanese relations took a more competitive slant long before President Xi Jinping articulated China's grand ambitions in his 2012 "Chinese Dream" speech and the Trump administration embraced the notion of great power competition in its 2017 National Security Strategy. The year 2008 is used to date the arrival of a more confident China — one which concluded that the global financial crisis underscored structural weaknesses of the American model. But 2008 is also the year when Japan graduated China from its ODA loan program, having reached a separate conclusion: with China's new stature, Japan's concessional aid could in fact be subsidizing Chinese rearmament and economic largess abroad. The strategic intent in Japan's foreign economic policy was evident throughout the 2000s in other policy departures: competitive trade diplomacy in Southeast Asia with the birth of Japan's preferential trade agreements,[11] the more explicit recognition of national security goals in aid giving, and a recommitment to big-ticket infrastructure investment after Japan strived in the 1990s for some convergence with the West's preference for poverty alleviation and social infrastructure programs. Nevertheless, Japan's own domestic constraints (protectionist interest groups, bureaucratic sectionalism, budgetary constraints, and the lack of executive leadership) compromised Japan's ability to execute on bold policy initiatives.[12]

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And yet, it was a profound domestic transformation, coupled with a more constrained international environment, that paved the way for Japan to play a more proactive role in international economic governance. As Saori Katada explains, the Japanese state moved away from a mercantilist past of nursing infant industries to a liberal geoeconomic strategy of forging international rules and regional institutions to level the playing field for globalized Japanese companies.[13] Such structural change enabled a novel collaboration between the United States and Japan to advocate for high standard trade liberalization in the Asia-Pacific. But the U.S.-Japan partnership in the Trans-Pacific Trade agreement (TPP) was not meant to be. The American pullout of the mega trade deal heralded a deeper U.S. inward turn that accelerated the erosion of the multilateral trade system. As a main beneficiary of the U.S.-led liberal international order, Japan's economic statecraft faced another major challenge: to help the open trading order survive the harsh realities of great power competition and the revival of economic nationalism. Tokyo's response to that challenge has been encouraging — the rescue of the TPP via the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) without the United States, a comprehensive trade agreement with the European Union, proposals for WTO reform to curb (Chinese) market-distorting policies, and blueprints for the governance of the digital economy showcased a new Japan.[14]

Economic statecraft stands to define Asia not only because a more powerful China is flexing its state-capitalism arm abroad, but also because Japan has overcome enough of its domestic limitations to offer economic leadership — with the diminished clout of protectionist groups, the arrival of political stability, and the centralization of power in the office of Prime Minister Abe. Both China and Japan are pushing visions of regional integration and offering development finance to see them through; but neither is pressing developing Asia with binary choices. The regional order in Asia is contested, but not exclusionary.

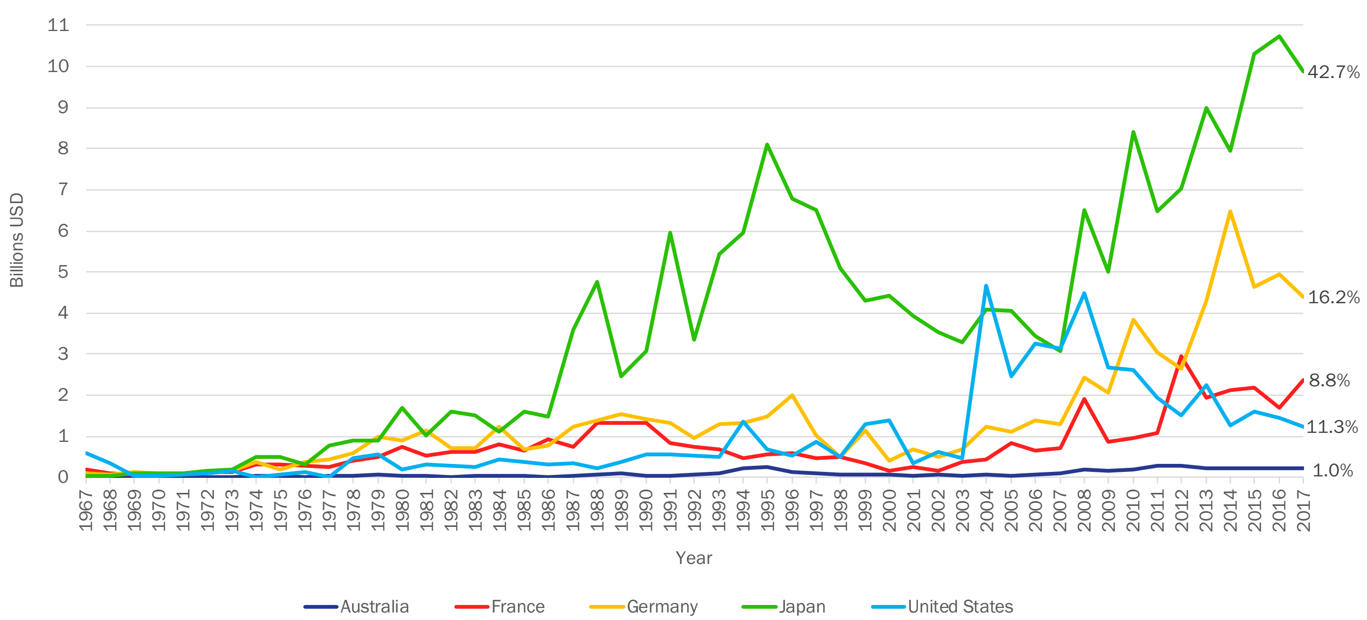
BUILDING A REGION, DEFINING THE WORLD

Economic engagement has been at the heart of Japan's and China's bid for international leadership. In the 21st century, the task for Japan has been to exert influence with dwindling resources (ODA budgets have been slashed for years) and avoid becoming a legacy power banking on the economic footprint built during its days of glory. For China, the major burst in material capabilities has purchased great influence, but significant challenges loom ahead in ensuring the long-term sustainability of BRI projects and preventing a backlash in recipient countries out of concern with onerous lending terms and/or undue political influence.

Comparing the muscle behind China's and Japan's economic statecraft is an inexact exercise at best given the paucity of Chinese data. A useful source of information is the AidData project which uses public information sources on specific projects to track China's economic footprint. It estimates that between 2000 and 2014, China's official finance commitments (ODA and Other Official Flows, OOF, such as export and investment credits) amounted to \$354 billion dollars.[15] During the same period, Japan's official finance (ODA plus OOF gross disbursements) amounted to \$305 billion, with and additional \$83 billion dollars disbursed between 2015 and 2017, according to Organisation for Economic Co-operation and Development (OECD) data.[16] The bulk of China's development finance centers on infrastructure with close to 60% of funds concentrated in energy, transport, and communications projects. The same is true for Japan. Figure 1 shows that Japan alone has provided 43% of all ODA committed to economic infrastructure projects by industrialized nations for the past four decades. And Japan's lead among Development Assistance Committee (DAC) nations intensified in the 21st century, a time when the country suffered deflation and domestic contraction and was buffeted by the global financial crisis and the March 2011 triple disaster (earthquake, tsunami, and nuclear accident). When it comes to the mobilization of state resources to finance economic infrastructure abroad, only Japan is in serious competition with China.

FIGURE 1: ODA COMMITMENTS IN ECONOMIC INFRASTRUCTURE

Percentages reflect country shares of cumulative total, 1967-2017



Source: OECD[17]

Another key source of capital for development is private investment. As creditor nations, both China and Japan have gone global. A comparison of outward foreign direct investment (FDI) activities before and after the global financial crisis appears in Table 1.

TABLE 1: FOREIGN DIRECT INVESTMENT OUTFLOWS

(Millions USD)

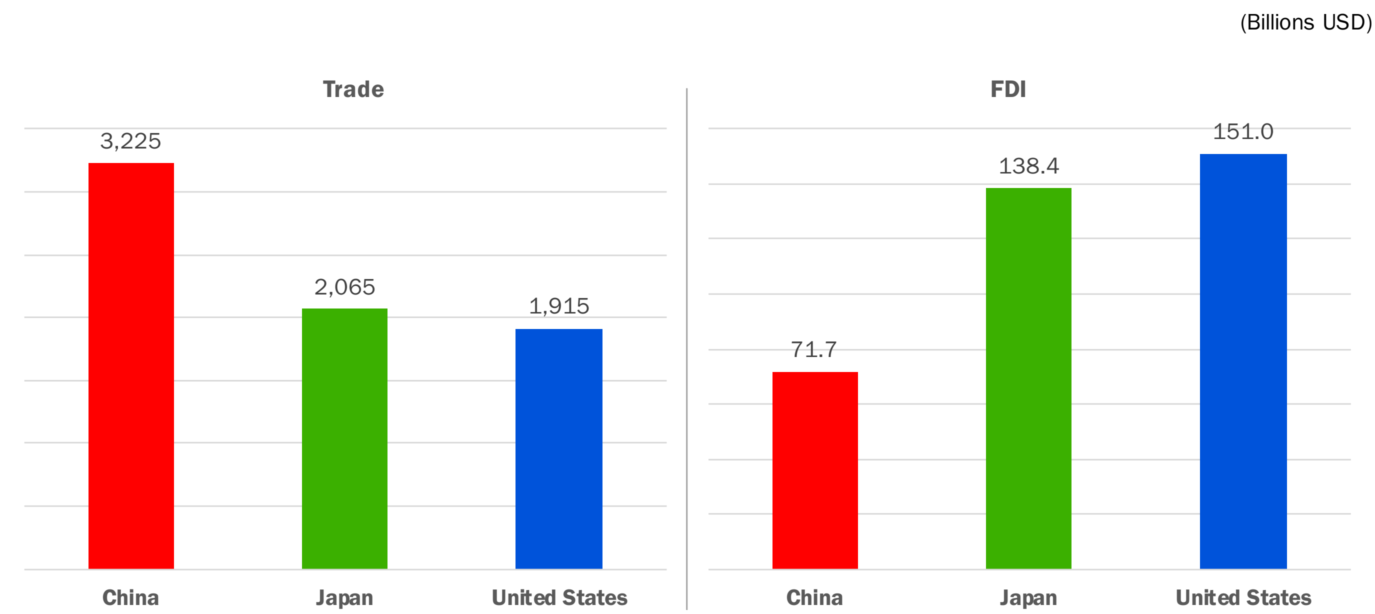
	2005-2007 (Pre-crisis annual average)	2008-2018 (Post-crisis annual average)
Japan	56,532	122,444
China	18,800	109,510

Source: United Nations Conference on Trade and Development[18]

Looking at annual investment averages, there are two main takeaways: 1) China and Japan have both rapidly expanded the tempo of their investment activities abroad since the crisis, and 2) China has quickly caught up, but not yet surpassed Japan. In the area of project finance for infrastructure, private Japanese banks lead the world, ranking first, second, and fourth in 2018.[19]

Through the supply of capital and the push for connectivity, Japan and China have been important drivers in the ongoing regionalization of Asia, with the share of intra-regional trade rising to 60%, and of intra-regional investment to 59%.[20] How does China's and Japan's economic footprint measure up in Southeast Asia, a region at the center of great power competition?[21] When it comes to infrastructure finance, Japan is ahead — according to a widely noted report by Fitch Solutions, with $367 billion dollars in pending projects across six ASEAN nations (Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam). Vietnam, with large infrastructure projects such as the $58.7 billion dollar high speed rail connecting Hanoi and Ho Chi Minh City, has been a focus of recent activity for Japan. Fitch puts the value of Chinese pending infrastructure projects in Southeast Asia at $255 billion, with the $17.8 billion dollar Kayan River hydropower plant in Indonesia standing out.[22] Figure 2 reveals an interesting contrast regarding the weight of ASEAN's trade and investment flows with the world's three largest national economies. On the left side of the graph, appears the well-known dominance of China as the region's top trading partner. On the right side, it is clear that China still lags behind Japan and the United States in terms of FDI flows to the region.

FIGURE 2: ASEAN'S TRADE AND INVESTMENT BY SELECTED PARTNER COUNTRY (2010-2018)



Source: ASEANstats[23]

> **“In the past few years China has learned that the road to becoming a titan of development finance is full of opportunity and risk.**

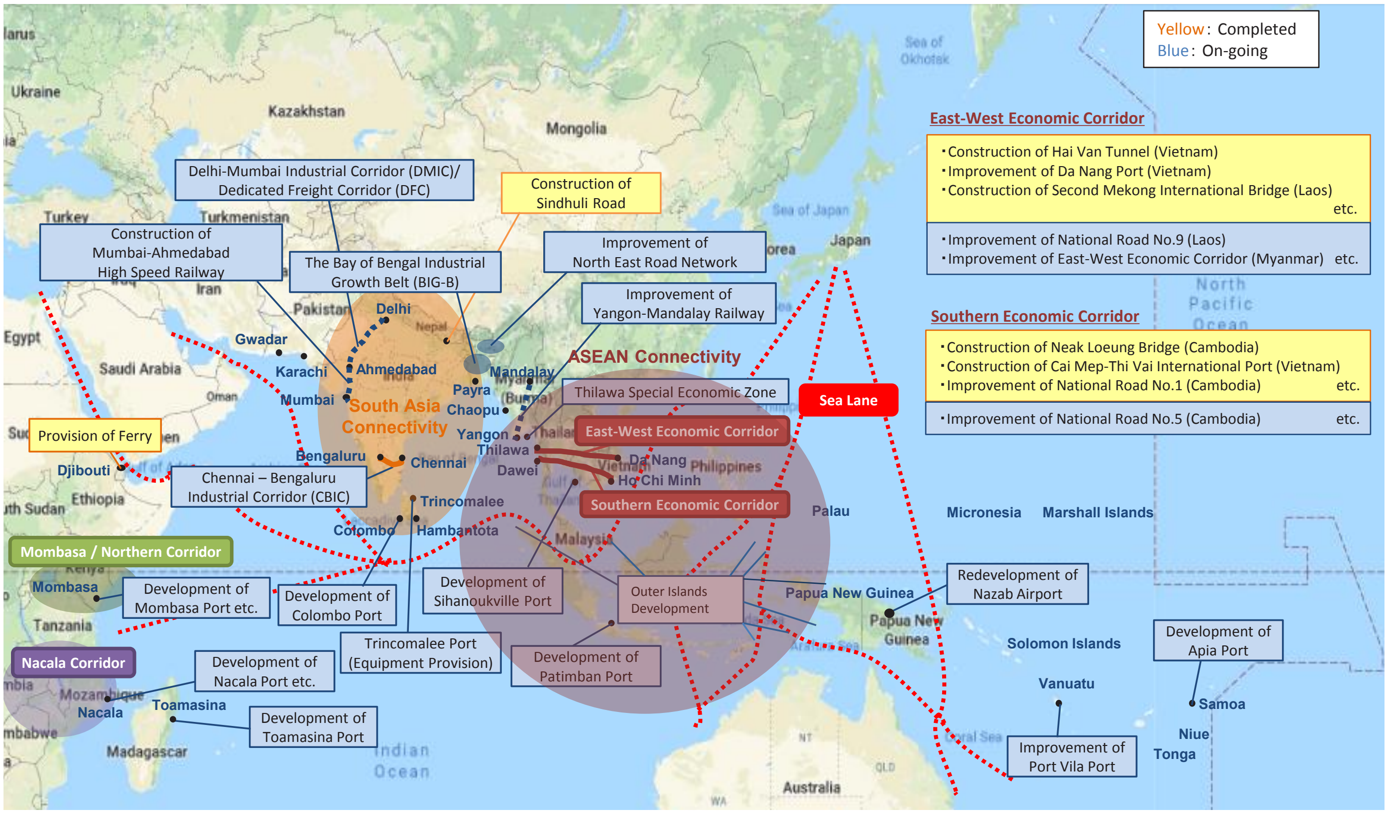
Leadership does not materialize without a compelling vision. China’s flagship initiative, the Belt and Road Initiative, has captured the world’s imagination with its promise to channel a trillion dollars towards the construction of economic corridors on land and at sea across Eurasia, and to do so by providing not only physical infrastructure but also digital connectivity. In the past few years, however, China has learned that the road to becoming a titan of development finance is full of opportunity and risk. China supplied a commodity keenly desired in the region — capital to ameliorate the infrastructure finance gap choking economic growth. Relying on policy banks that are less constrained by exacting lending standards of multilateral development banks, but offer credit on less concessional terms, the Chinese state extended loans for infrastructure projects, animated by a mix of objectives. The motivations have ranged from the purely economic (nurturing domestic industries, disposing of excess capacity, promoting the regional integration of hinterland provinces) to the strategic (expanding its political influence on recipient countries, gaining access to ports across the region that ease Chinese concerns over maritime chokepoints, etc.).[24]

However, concerns over onerous lending terms, have brought greater international scrutiny, and in some instances, loan renegotiations as evidenced in Malaysia’s East Coast Rail project. Looking at data on external debt relative to gross national income, David Dollar concludes that among BRI recipients in Southeast Asia, only Laos is at risk of insolvency.[25] Even if unsustainable debt is not as widespread as commonly asserted, China is aware that fragile BRI projects will siphon away precious financial resources at a time when its domestic economy is slowing down, and could backfire in terms of deepening ties with target countries. Hence, the Chinese leadership recalibrated during the second Belt and Road Forum for International Cooperation in spring 2019 (at least rhetorically) by adopting the concept of “quality infrastructure” — long Japan’s calling card in this field.

For the first time, Japan has offered an ambitious blueprint for regional development and stability, coining the Free and Open Indo-Pacific construct (FOIP) with a whole-of-government approach. Its animating principles are rule of law, democratic values, freedom of navigation (with capacity-building initiatives for maritime law enforcement), and economic connectivity (through quality infrastructure finance and a free trade architecture that provides rules for free flows of data and governance of the digital economy).[26]

Rising and established powers (China, India, and the United States) have been important reference points in the evolution of this landmark Japanese initiative. Japan has coped with China’s growing ambitions and capabilities by stretching the boundaries of the region, beyond East Asia, to include Australia, New Zealand, India, and the United States in regional institutions and collaborative efforts, such as the East Asia Summit or the Quad. Hence, the Indo-Pacific is envisioned as the confluence of two oceans and the connection of two continents (Asia and Africa). Prime Minister Abe articulated this vision back in 2007 in a speech to the Indian parliament, highlighting the priority of raising the strategic partnership with India. Bilateral ties between Japan and India have deepened with the establishment of a 2+2 dialogue of foreign and defense ministers, Japan’s participation with the U.S. and India in the annual Malabar military exercises, and plans for an acquisition and cross-servicing agreement for military supplies. Importantly, India has refrained from partaking in the BRI for geostrategic reasons, giving Japan an important advantage in Asia’s third-largest economy. The broad geographical remit of Japan’s connectivity agenda (see Figure 3) means that Japan is active in Southeast and South Asia, the Pacific Islands, and Africa, areas of brisk Chinese BRI activity.

FIGURE 3: JAPAN'S CONNECTIVITY INITIATIVE



Source: Ministry of Foreign Affairs, Government of Japan[27]

In FOIP, Japan aims to sustain the rules-based order that is at the core of its security and its prosperity, to anchor the United States to the region to avoid a power vacuum, and to boost and redefine the alliance's division of labor to maximum effect. As Sheila Smith reminds us, Japan rearmed but struggled to find a foreign policy role for its growing military capabilities. However, under the rubric of cooperative security, Japan has increasingly partaken in peacekeeping and anti-piracy operations, and has used ODA budgets to enhance the Coast Guard capabilities of South China Sea claimant states.[28] Moreover, as Figure 3 makes evidently clear, it is Japan who is able to add an economic engagement dimension to its shared goal with the United States of a free and open Indo-Pacific: investments in ports and high-speed railway networks, and the construction of broad economic corridors with improved transportation links, power generation plants, and special economic zones.

Japan has felt competition with China keenly. Tokyo abstained from joining the AIIB as founding member citing concerns over the new bank's internal governance and worried about weakening the clout of the Asian Development Bank. Instead, in the spring of 2015, Prime Minister Abe announced the Partnership for Quality Infrastructure in Asia with a commitment of $110 billion dollars, later expanded globally to $200 billion to be disbursed in five years. Tokyo embarked on a diplomatic campaign to codify its quality infrastructure standards across a broad set of platforms: Asia-Pacific Economic Cooperation (APEC), the OECD, the G-7, and, most recently, the G-20. These principles (open access to infrastructure services, transparency of procurement, debt sustainability, and economic efficiency over the lifecycle of the project) are geared to highlight Japan's competitive assets in development finance. But Japan has lost significant project bids to China. The decision of the Indonesian government in 2015 to award to China the Jakarta-Bandung high speed railway project was a blow to Tokyo. The fracas encouraged Japan to recalibrate its lending practices with China in mind: building greater tolerance to financial risk in its official credit disbursing agency, expediting yen loan approvals, and exempting recipient governments from extending loan guarantees under certain conditions.[29]

How much political capital are China and Japan deriving from their vigorous programs of development finance? Traditionally, this question has focused on the ability to use economic inducements to create relations of trust with recipient countries. By this measure, Japan is far ahead. A recent ISEAS survey has Japan in the lead on "trust" rankings with 61.2% in positive responses and China at the bottom with 16.1%. This trust is particularly important at a time of increased great power competition. Japan ranks at the top as strategic partner for countries in the region to make up for U.S. disengagement (31.7%), and for ASEAN to broaden its strategic options with third parties (38.2%).[30]

As Corey Wallace astutely observes, the question is whether China can emulate Japan's past success in overcoming regional suspicions of its return to major power status. Concerns in Southeast Asia about Japan's expanded influence were not minor, they peaked in 1974 with the so-called Tanaka riots in several cities in the region toured by the Japanese prime minister. Nor were the local frustrations dissimilar to today's concerns vis-à-vis China: complaints about economic dominance and self-serving objectives, plus fear about the revival of military power. Japan rebuilt relations with Southeast Asia by enlarging aid with more generous terms, and engaging more deeply with ASEAN, developments encapsulated in the Fukuda Doctrine.[31] Does China have the will and ability for such a rethink in its Southeast Asia policy? The required lift for China will be much steeper in light of ongoing territorial frictions (with its expansive claims in the South China Sea), and charged ethnic/religious issues (Xi's emphasis on reconnecting with the Chinese diaspora in pursuit of a "Chinese Dream" and his crackdown of Muslim Uighurs in Xinjiang).

Donor-to donor relations are a second avenue to cultivate political capital. Coordinated action in infrastructure finance can serve as an opportunity to showcase shared development and foreign policy priorities and to develop habits of cooperation among implementing agencies. Individual donors may also be interested in pooling efforts for reputational benefits: to assure both recipients and fellow donors about underlying motivations and the soundness of lending practices. And so many have prescribed for China to multilateralize the BRI in order to instill confidence on its development finance push. However, the challenge for China is steep, as noted by Brad Parks. China has not taken full responsibilities as member of the Paris Club for creditor nations, has chosen not to abide by the OECD's export credit guidelines, and the opaqueness in BRI loans preempts cooperation with other international development finance agencies.[32] In fact, Japan is better poised to multilateralize its Partnership for Quality Infrastructure to signal a commonality of purpose with fellow donors. Tokyo has launched coordinated infrastructure funds with the United States, Australia, India, and the European Union. And the Abe cabinet has also opened the door for cooperation with China on infrastructure projects in third countries, provided China adopts its quality infrastructure standards, as part of a campaign to improve Sino-Japanese relations.

SINO-JAPANESE RAPPROCHEMENT: MUCH ADO ABOUT NOTHING OR MUCH ADO ABOUT THE UNITED STATES?

The Trump presidency has been a major factor behind the visible thaw in Sino-Japanese relations. Growing uncertainty about the role of the United States created a powerful incentive for Asia's great powers to stabilize their relationship after years in deep disrepair. Beijing is reeling from a bruising trade war which is perceived as just the first chapter of a wider strategic contest with the United States; Tokyo is seeking to improve its external environment at a time when the American president is critical of trade agreements and basing financial arrangements; and may compromise with the North Korean leader on missile and nuclear capabilities at the expense of Japan's security. Japan is not a believer in wholesale decoupling either, keenly aware of the pull of the Chinese market (China's share of Japan's trade is 24% compared to 15% for the U.S.).

In this context, Beijing and Tokyo's desire to avoid a flareup in bilateral discord is understandable. Sino-Japanese political dialogue, frozen since the Japanese nationalization of the disputed islands in late 2012, was reinitiated at the highest level. Premier Li Keqiang visited Japan in May 2018 (first visit by a Chinese premier in eight years), Prime Minister Abe visited China in October 2018 (first bilateral visit by a Japanese leader in seven years), and President Xi is expected in Tokyo as state guest in the spring of 2020 (almost 12 years since the last bilateral visit of a Chinese leader). To mark the occasion of Xi's visit, officials from both countries are believed to be working on a fifth political document, setting the foundation for future bilateral relations with emphasis on cooperation in areas such as climate change.[33]

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The improvement of bilateral ties, however, is no prelude to a reordering of Asian geopolitics. There is no seismic change in security alignments at work. If anything, the trendline of the past decade continues: China exerting pressure on Japan's administrative control of the Senkakus, and Japan investing in deterrence capabilities with China foremost in mind, betting on the alliance with the U.S. (with forays into collective self-defense, concessions on trade, and Abe's personal diplomacy with Trump), and fostering security partnerships with like-minded democracies.[34] Rather, the current rapprochement is interesting for what it reveals about the ability of Chinese and Japanese leaders to make pragmatic adjustments to new realities in international politics, and the keen sensitivity displayed by the Asian powers to an unpredictable United States. But it is also indicative of the difficulties to execute limited collaboration amongst them — official blessings aside.

Reflecting the centrality of economic statecraft in this era of Japan-China relations, infrastructure finance emerged front and center in the effort to warm up ties. Nevertheless, finding how to cooperate has been far from straightforward. The ADB and AIIB have jointly financed some projects, but Tokyo has not changed its mind about formally joining the Chinese-led institution. And China has sought what Japan is not prepared to give: an unequivocal endorsement of BRI. China pushed for placing cooperation with Japan under the BRI umbrella; Japan demurred noting that BRI can make a positive contribution *provided* it operates with the international standards Japan has consistently advocated.[35] Neither side is prepared to endorse the other's flagship initiative (BRI and FOIP), and so they have settled for a more modest endeavor: to encourage business cooperation in third-country markets. At the time of Prime Minister Abe's visit to China in October 2018, 52 memoranda of understanding (MOUs) of such business cooperation were announced. These MOUs encapsulate a desire to pursue future cooperation in fields such as transportation, energy, the new economy, and health care; they remain unimplemented.

As a statement of official intent to collaborate on infrastructure finance, the MOU between the Japan Bank for International Cooperation (JBIC) and the China Development Bank (CDB) is most consequential. Here too, Japan's conditional approach to engaging with China is evident since the document includes an explicit reference to the global standards that would predicate such joint effort (openness, transparency, economic viability, debt sustainability, and rule of law). JBIC and CDB first set their eyes on Thailand's Eastern Economic Corridor (with high-speed rail projects connecting three airports and plans for a smart industrial park). But the lofty aspirations soon came aground, when Japanese private companies pulled out due to concerns with the commercial viability of the venture.[36]

Development finance has not emerged as a vehicle for political cooperation between China and Japan, and the ability of both parties to find joint infrastructure projects that are viable is still in question. But the bilateral effort to signal potential for cooperation is not meaningless, for it is directed to a larger audience. It signals to developing countries in Asia and beyond that neither Asian power is casting infrastructure finance as a zero-sum match.

Other arenas of economic statecraft, however, are likely to pose a harder edge for Sino-Japanese competition. China's bid to become a leader in and achieve greater self-sufficiency on frontier technologies such as artificial intelligence (AI), robotics, smart manufacturing; could redefine the terrain for Japan-China economic interdependence. With the growth and deepening of global supply chains, equipment and technology products have hitherto figured prominently in two-way trade between China and Japan. Of China's 2017 $20.2 billion dollar merchandise trade deficit with Japan, machinery and electrical equipment occupied the lion's share.[37] And according to an estimate by Tomoo Marukawa, 15% of Japanese exports to China in the 2000s were comprised of sensitive dual-use items (such as integrated circuits).[38]

China's technological push (with research and development investments that far surpass Japan's), its industrial policy goal of achieving 70% domestic content in core materials and components with a central role to state-owned enterprises (SOEs) and generous public subsidies in targeted sectors ("Made in China, 2025"), and the 2017 Cybersecurity Law giving the state greater reach into telecoms have brought an acute quandary to Tokyo's footstep: how to balance economic internationalism and economic security. Japan's concerns with technological leakage (weak intellectual property protection in China and pressure on Japanese companies to surrender proprietary knowhow to enter the Chinese market) are longstanding. The novelty lies in the fact that Japan has catapulted to a leading role in drafting international trade and investment rules. Japan's proactive stance is evident not only in the CPTPP, but also in the tripartite effort with the United States and the EU to codify new disciplines on market-distorting policies (forced technology transfer, investment restrictions, unfair advantages to SOEs, lack of transparency on subsidies, etc.). Hence, Japan's planned contribution to WTO reform aims to curtail the very same practices that China has used and/or will continue to rely on in its technology upgrading bid.

Another major thrust of action has emerged: defensive measures to prevent technology flows that could harm national security. The Japanese government recently embarked on greater integration of economic policies with national security, establishing an economic division in the National Security Secretariat. Japanese officials have worried that the tightening of investment and export controls in the West could make Japan a soft target for the acquisition of critical technology that could be diverted to military use. An overall review of export controls (with a focus on AI and how to handle the results derived from basic research), and tightened the screening of foreign direct investment have become priorities.[39] Revisions to the Foreign Exchange Law approved at the end of 2019 mandate that foreign investors need to receive prior approval for stock acquisitions above 1% in designated sectors (the prior threshold was 10%). Exemptions to the approval process can be granted if the foreign investor foregoes a board position or access to critical technology in the company. The backlash from foreign investors has been steep, deeming these regulatory changes harmful to Japanese innovation, productivity, the goal of doubling foreign direct investment, and the consolidation of corporate governance reforms.

Japan is, therefore, entering unfamiliar terrain on how to reconcile globalization with national security. Such tradeoffs are only likely to grow. The U.S.-China technological rivalry is intensifying; Japan itself has deemed Chinese telecom firms (Huawei, ZTE) a cybersecurity risk, effectively banning them from 5G government contracts; and internationalized Japanese firms will not only have to navigate tightened domestic regulations, but also forthcoming American export controls on foundational and emerging technologies. Economic security is fast becoming the new frontier of Asian power competition.

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