

DEALING WITH A PROACTIVE JAPAN

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An enhanced New Zealand-Japan relationship promises various economic, scientific, and security benefits while potentially posing problems for how New Zealand manages its special relationship with China. Even given recent geopolitical tensions in East Asia, there are ways of pursuing a mutually beneficial NZ-Japan relationship without precipitating a 'China choice.'

Key findings

- New Zealand's recently enhanced 'strategic partnership' with Japan could detract from New Zealand's unique relationship with China
- Japan is more economically and politically important to New Zealand than headline trade figures suggest
- This makes a 'China choice' of subordinating NZ-Japan relations to NZ-China relations premature

Executive summary

An increasingly regionally proactive Japan offers various economic, scientific, and security benefits to New Zealand. A closer relationship with Japan, however, poses problems for how New Zealand manages its relationship with China due to Sino-Japanese bilateral tensions over territory and history, as well as an intensifying regional rivalry. As China's quantitative economic impact upon New Zealand's economy will increase at a faster rate than Japan's impact, will New Zealand have to make a 'China choice' between China and Japan by subordinating the Japan relationship to the China one? It is premature to make such a choice and hold back on the relationship. Japan itself is looking to find a new strategic accommodation with China at the same time it is diversifying its economic relations to strengthen its hand in dealing with China. As New Zealand is uniquely vulnerable to Chinese economic downturns and economic coercion, it is preferable for New Zealand follow a similar path. New Zealand should improve bilateral links with Japan, while also pursuing enhanced relations countries in Southeast Asia in ways that may include cooperation with Japan. As long as New Zealand manages the sensitive defence aspect of the NZ-Japan relationship vis-à-vis China, Chinese irritation should be manageable.



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Why does this matter to NZ?

Two-way trade between New Zealand and Japan grew to \$7.4 billion in 2016, and the trade relationship is a diversified, mature, and resilient one.¹ There has also been a 400% increase in total investment from Japan since 2001. Both countries are also involved in RCEP and TPP negotiations. In recognition of various developments, including cooperation on scientific research and the 2019 Rugby World Cup, the two governments upgraded their relationship in 2013 to a 'Strategic Cooperative Partnership'. A Japan-New Zealand memorandum of defence cooperation and exchange was signed later in 2013. On the back of a renewed military relationship between NZ and the US, the New Zealand Defence Force has also come into more regular contact with Japan's Self-Defence Forces. Now there is discussion of bilateral training exercises, and Japan is even proposing sharing defence equipment.

Tensions between the two countries over the whaling issue have been better managed recently. The current barrier to a more strategically engaged bilateral relationship is due to differing sensitivities to China's regional military and economic behaviour and influence. The New Zealand government likes to tout its relationship of 'firsts' with China, which now includes New Zealand being the first developed country to become a prospective founding member of the Asian Infrastructure Investment Bank (AIIB), and the first Western country to sign a 'Memorandum of Arrangement' on the Belt and Road Initiative.

China's quantitative economic impact upon New Zealand's economy is set to increase at a faster rate than Japan's impact. If New Zealand forges an even closer relationship with Japan, particularly in the defence realm, there are worries that New Zealand will undermine the generally positive relationship with China that has already seen the tripling of annual two-way trade (\$22.8 billion as of December 2016) since the 2008 NZ-China Free Trade Agreement. Exports to China alone account for 18.2 percent of total New Zealand exports compared to just 5.7 percent for Japan in 2016.² New Zealand in many ways has a similar dilemma to Australia. Australian exports to China make up approximately 27.5 percent of total exports, just over double the value of exports to Japan (12.2 percent).³ Australian commentators and past political leaders have criticised positive Australian government diplomatic overtures to Japan as potentially jeopardising Australia's apparently more important relationship with China. A key question is, therefore, will New Zealand have to make a 'China choice' not just between China and the US, but between China and Japan by subordinating the Japan relationship to the China one?⁴

Two factors should be considered.

First, Japan's economic value to New Zealand can be underestimated if we rely on headline bilateral trade figures. Japan's investment stock in New Zealand (\$11.8 billion) is close to double that of the mainland China (\$6 billion) alone, and even including Hong Kong puts Japan not far behind (\$14 billion). New Zealand entrepreneurs are increasingly active in Japan, and New Zealand investment stock in Japan has tripled since 2011 (now \$10.5 billion), making the investment relationship roughly equal. By comparison, New Zealand investment in China and Hong Kong is less than half of that of Chinese and Hong Kong investment in New Zealand (\$6.3 billion). Qualitatively, Japan's capital investment in New Zealand tends to be less focused on strategically sensitive sectors than Chinese investment (e.g. dairy, forestry or land-purchases). Japanese investment is less domestically controversial and arguably more productivity-enhancing. Japan's integrated trading houses and merchandise companies are also very effective established players in regional and global logistics



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facilitation and distribution networks, and are intimately connected into regional supply chains and production networks. Just one notable example is the global beverage industry. It is therefore significant that Japanese companies own Lion Nathan, Charlie's and Independent Liquor, in addition to partial stakes in DB. The potential for strategic alignments with Japanese companies to distribute New Zealand products is therefore significant outside the bilateral trade context.

The scientific relationship is also one of significant economic value-add. The Japanese government is increasingly looking to diversify Japan's industrial structure from a focus on automobiles and electronics exports to focus on health and biotechnology (amongst others), which are research strengths for New Zealand. New Zealand also has significant agricultural, environmental and renewable energy expertise that addresses Japan's critical food and energy insecurities.

Second, New Zealand would be wise to reduce the degree of dependency on the Chinese market and enhance diversity of its economic relations with other nations. New Zealand is actually uniquely vulnerable. Not only is there significant dependence and asymmetry of economic size, but New Zealand's Chinese export profile make it uniquely vulnerable to Chinese economic downturns (especially education and tourism) and to economic coercion.⁵ On the latter point, New Zealand's primary sector and finished goods exports, and travel and educational tourism, could easily be affected by government executive actions and/or consumer boycotts. Industrial intermediates and inputs into regional production chains are however more resilient during economic downturns and more difficult to target economic coercion against.

What should NZ do?

Ultimately a better balanced country-level economic portfolio is essential if New Zealand cannot sufficiently diversify its reliance on primary sector exports, education provision and tourism.

An enhanced bilateral economic relationship with Japan would be one possibility. Additionally, other countries and subregions in the Indo-Pacific will grow as fast if not faster than China in the future while also offering potentially similar trading benefits at a still significant scale. The Japanese government is also seeking to diversify its investment portfolio and exports to other emerging nations. Greater cooperation between New Zealand and Japanese companies offer opportunities to export to emerging markets in Asia and Africa. The current initiative to forge a TPP-11 in the absence of the United States is a good example of one way to pursue such an agenda. Cooperation on political stability in Southeast Asia and enhancing ASEAN-centrality would also be mutually beneficial. This could include greater cooperation on ODA projects, and enhancing regional non-traditional security capacity through maritime security human resource cultivation, peacebuilding, and humanitarian assistance and disaster relief activities.

Increased cooperation and intimacy between New Zealand and Japanese militaries should be manageable in the context of potential Chinese irritations. First, there are institutional and capability mismatches that limit how far the bilateral military relationship could deepen. Second, Japan does not expect or need New Zealand participation as an 'ally' in any Northeast Asia contingency, so there is little possibility of entrapment in Sino-Japanese conflict over East China Sea issues. Points one and two mean that a lack of a 'quasi-alliance' with Japan, such as we are seeing develop with Australia, is not due to a purposeful strategic calculation on New Zealand's part. Third, greater operational and educational cooperation in the non-traditional security sphere would both be valuable to each nation while unlikely to stimulate strong pushback from China.



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Conclusion

It would be unwise to hold back on enhancing the relationship with Japan by overreacting to regional tensions. The reality is that Japan and China have strong economic connections and interests in each other bilaterally but also in economic region building. There are also expectations that Sino-Japanese bilateral relations will improve temporarily over the next 2-3 years. New Zealand should take the opportunity of this upcoming window to build on the relationship with Japan, diversify its regional economic connectivity, and be confident in managing and profiting from its relations with both China and Japan.

¹ NZ Stats, 'Goods and Services Trade by Country: Year ended December 2016', March 2, 2017: http://www.stats.govt.nz/browse_for_stats/industry_sectors/imports_and_exports/GoodsServicesTradeCountry_HOTPYeDec16/Tables.aspx

² NZ Stats, 'New Zealand trade, investment, and migration by country – fact sheets', April 4, 2017: http://www.stats.govt.nz/browse_for_stats/industry_sectors/imports_and_exports/trade-investment-migration-factsheets.aspx

³ DFAT, 'Australia's trade in goods and services 2015-16', February 17, 2017: <http://dfat.gov.au/about-us/publications/trade-investment/australias-trade-in-goods-and-services/Pages/australias-trade-in-goods-and-services-2015-16.aspx>

⁴ Benjamin Schreer (p.38) provides a summary of similar concerns raised in the Australian context: Benjamin Schreer (2016) Australia's 'special strategic relationship' with Japan: another 'China choice?', *Australian Journal of International Affairs*, 70:1, 37-49, DOI: 10.1080/10357718.2015.1058340

⁵ Our services exports are comprised of 98 percent personal and educational travel, and have grown 113 percent since 2012. Compared to goods exports, which grew 37 percent between 2012 and 2016



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