
THE IRONY OF CHINA-JAPAN RELATIONS: WHY DO THEY 'COOPERATE' DESPITE THE 'CONFLICT'?

PRERNA GANDHI

INTRODUCTION

It is ironical that China and Japan despite sharing a history of two millennia as neighbours, are ranked as the number one hostile bilateral relationship in G-20¹. Events since the end of 19th century have created a long baggage of historical memories that strongly defines their relations in the present day. However, the strong economic integration between the two countries has led to it becoming the third largest bilateral trade relationship in the world, amounting to \$334 billion² (2012 figures) just behind the US-Canada and US-China bilateral relationship at \$645 billion³ and \$536 billion⁴ respectively. China surpassing Japan in 2010 to become the second-largest economy in

Prerna Gandhi is a Research Associate at the Centre for Air Power Studies, New Delhi.

1. Ian Bremmer, "The Top 10 Grudges in the G-20", March 7, 2013 at <http://blogs.reuters.com/ian-bremmer/2013/03/07/the-top-10-grudges-in-the-g-20/>.
2. Michael Schuman, "China and Japan May Not Like Each Other, but They Need Each Other", December 1, 2013, at <http://world.time.com/2013/12/01/china-and-japan-may-not-like-each-other-but-they-need-each-other/>.
3. Doug Lamborn, "Building Keystone Pipeline will Cement US-Canada Relations", June 3, 2013, at <http://thehill.com/opinion/op-ed/286669-building-keystone-pipeline-will-cement-us-canada-relations>.
4. Amy He, "Strong Business Ties US-China's Future", October 16, 2013, at <http://thehill.com/opinion/op-ed/286669-building-keystone-pipeline-will-cement-us-canada-relations>.

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the world following the US, created widespread ramifications not just for the global economy but even the international political system. Since both countries are intimately connected—economically and politically—with the United States, the implications of the China-Japan relationship have gone far beyond the purview of bilateral relations. While the world's largest and third-largest economies happen to be strong allies with a security treaty, the world's second-largest economy happens to be an adversary of both of the former largest and third economies at the moment. Hence, the way China and Japan relate to each other shapes not just their regional roles but also influences the security environment of the entire region.

Complicating the picture is that this is the first time that the region has seen both a powerful China and powerful Japan. As the former US National Security Council adviser Michael Green stated, "Japan and China are powerful now at the same time, essentially, for the first time in history. They both have somewhat different visions for the future of Asia. They both want to play a leadership role, and they are in competition⁵." Following the end of the Cold War, China with its double digit figures of both economic growth and military budgets contrasts sharply with the straight two decades of stagnation and apparent pacifism of Japan. Also the renewed tensions over the Senkaku/Diaoyu Islands since 2010 with China unilaterally declaring an Air Defence Identification Zone (ADIZ) over the islands in the East China Sea in late 2013, threatens to escalate the area into a potential war zone. However, what is truly interesting is that just two days after the ADIZ was declared and led to a widespread furore in the region, on November 25, China and Japan, along with South Korea, sat down to discuss a trilateral free-trade agreement covering a market of more than 1.5 billion people, with an estimated \$690 billion in the annual

5. Paul J. Smith, "China Japan Relations and the Future Geopolitics of East Asia", *Asian Affairs: An American Review*, vol. 35, no. 4, August 07, 2010, pp 230-256 from <http://dx.doi.org/10.3200/AAFS.35.4.230-256>.

trade volume⁶. Hence, while increasing economic interdependence may be a deterrent for conflict, it nevertheless also seems to fall short of becoming a cause for peace.

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Barack Obama's shifting American military and diplomatic "pivot": or "US rebalancing strategy" to the Asia-Pacific puts the two regional neighbours into a greater international spotlight. The fact that after World War II, Japan was engaged in a security alliance with the United States, diminished Beijing's fears that, at least in the short to intermediate term, Japan might reassert its World War II era disposition toward militarism. However, Beijing now views the same alliance (and efforts to upgrade it) as the US and Japan's joint efforts to counter China's military power. Historical legacies that were negotiated in the 1980s and early 1990s to pursue economic development are now viewed as irreconcilable factors in the bilateral relations. The East China Sea conflict has become an excuse for both countries to pursue military growth as China and Japan emphasise each other as viable threats to their security. Manoeuvring between political priorities and economic necessity is increasingly becoming a thin line for both the countries. Also, with East Asia leading the world with its sustained economic growth for the past three decades, the centre of the international political economy has shifted from the Atlantic to the Pacific. Hence, the bilateral relationship between the second- and third- largest economies in the world has not just regional but also global implications because of the extensive production networks in which both economies are involved.

Studies have found that territorial disputes, conflicting political interactions and anticipated military conflicts are all associated with reduced trade flows, and states with similar political interests tend to trade more with

6. Michael Ivanovitch, "China and Japan Trading Goods and War Threats", December 29, 2013, at <http://www.cnbc.com/id/101300548>.

each other than do other states⁷. *So the hostile political relations between China and Japan beg the question of why extensive economic interactions exist, and in this paper, we will attempt to infer the answers to the above question and use their implications to conclude whether the recent flare-up of tensions is a sign of bigger conflict or will cool down with time.*

POLITICAL CONFLICT VS. ECONOMIC COOPERATION IN 2000S

The first decade of the new millennium began on an awkward note for China and Japan as a result of the 2001 tariff dispute. Seeing China's booming growth at a time when Japan still lingered in domestic economic stagnation, some Japanese began to view China as an economic challenger. The "China threat" theory reached its peak days before Koizumi occupied office in April 2001. The Japanese government imposed temporary safeguards to reduce the imports of leeks, shiitake mushrooms, and reed mats for tatami flooring. Because these items were mainly imported from China, Beijing retaliated in June by declaring 100 percent duties on the import of Japanese vehicles and other manufactured goods. Since the Japanese imports to China were higher in value (almost 8 times of Chinese imports) and threatened huge losses to the automobile sector, the Japanese government retracted the tariffs by the end of the year. With the resolution of the tariff dispute and prominent economic opinion in Japan echoing Koizumi' at the first Boao Forum, it was accepted that the flourishing Chinese market would be highly important for Japanese businesses, if not essential for rescuing Japan from its economic recession⁸.

China was seen as the rationally optimal location for Japanese manufacturers to establish production facilities in the lowest value-added midstream section of the value chain [between the upstream Research and Development (R&D) and downstream marketing sections]. Japanese businesses began recognising that final assembly in China was no threat

7. Scott L. Kastner, "When Do Conflicting Political Relations Affect International Trade?", *The Journal of Conflict Resolution*, vol. 51, no. August 4, 2007, pp 664-688 from <http://www.jstor.org/stable/27638570>.

8. Scott Wilbur, "The Political Influence of Economic Dependence in Japan's China Policy since the Koizumi Administration" at <http://aacs.ccny.cuny.edu/2011conference/Papers/Wilbur,%20Scott.pdf>.

to Japan's prosperity, so long as it used Japanese standards, with Japanese designed parts, on Japanese production equipment built in Japan with key technological innovation left to Japan. With China joining the World Trade Organisation (WTO) on December 11th 2001⁹, and further establishment of the China-Japan Economic Partnership Consultation in April 2002 as a formal dialogue to manage trade issues, China's economic threat was rarely discussed in the Japanese press by 2003, and that year, the country became the second-largest destination for Japanese Foreign Direct Investment (FDI) after the US¹⁰. After a mustard gas leak in the northeast Chinese city of Qiqihar in August 2003 (that left one person dead and 43 injured) was traced to Japanese chemical weapons abandoned in the area after World War II, the Japanese government rapidly offered 300 million Japanese yen (about US\$2.4 million) to the Chinese government for the management of the aftermath more than a month after the poisoning incident occurred. In a lawsuit that followed, the Tokyo court also ruled that Japan must remove the estimated 762,000 weapons still left in China before the year 2012 under the terms of the 1997 Chemical Weapons Convention¹¹. About two months after the Qiqihar incident, 13 Chinese victims, who were injured by deserted chemical weapons in the span from 1974 to 1995, also finally won a lawsuit that had been dragging for eight years from 1998¹².

Over the past decade, Chinese victims of the Japanese invasion filed more than 20 compensation lawsuits to Japanese courts, but few got a favourable ruling and only the 1998 chemical weapon injury lawsuit recovered losses. Though the Japanese government admits that its invasion army left chemical weapons in China, so far, Japan has not yet provided the Chinese government with any documents on the making, use and desertion of chemical weapons which makes it impossible for China to spot these hidden

9. "Member Information China and the WTO" at http://www.wto.org/english/thewto_e/countries_e/china_e.htm.

10. Scott Wilbur, "The Political Influence of Economic Dependence in Japan's China Policy since the Koizumi Administration" at <http://aacs.ccnycunycuny.edu/2011conference/Papers/Wilbur,%20Scott.pdf>.

11. "Japan to Pay 300 mn for Qiqihar Incident", October 19, 2013, at http://www.chinadaily.com.cn/en/doc/2003-10/19/content_273362.htm.

12. "Chemical Weapons Victims Claim Compensation, Apology from Japan", at <http://www.humanrights.cn/zt/magazine/2004020051215153418.htm>

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dangers. Also, with North Korea withdrawing from the Nuclear Non- Proliferation Treaty (NPT) in 2003, Japan in late 2003, announced its decision to build missile defence strength joint-efforts with the US and introduce the Aegis Ballistic Missile Defence(BMD) system of sea-based mid-course defence as an upper-tier capability, and the Patriot PAC-3 for lower-tier ground-based terminal defence¹³. It drew tremendous criticism from China and Russia with the huge spending on its “self-defence”. The International Peace Cooperation Law’s (IPCL’s) amendment to enable Japan’s participation in combat roles along with non-combat roles in international peace-keeping forces with the Anti-Terrorism Special Measures Law passed in 2001 had broadened the definition of Japan’s self-defense and allowed Japan to support the US military on foreign territory. Further initiatives post 2000 indicated a marked change from Japan’s passivity as a partner in the US-Japan security alliance as indicated by the Iraq Reconstruction Assistance Special Measures Law passed in 2003 with its 2004 dispatch of ground troops for the first time since World War II to a country in which fighting was still going on¹⁴. Hence, the very security alliance that had China approved was slowly becoming a possible threat to China, with Japan attempting to define a stronger role for itself in world affairs.

CHINA’S INCREASING DEMAND FOR OIL AND REVIVAL OF ISLAND DISPUTE

China surpassing Japan to become world’s second largest consumer of oil in 2003¹⁵ was almost an indication that the long-buried hatchet over the Senkaku/Diaoyu Islands would become a major source of controversy.

13. Hideaki Kaneda, “Japan’s Missile Defense Diplomatic and Security Policies: In a Changing Strategic Environment”, at http://www2.jiia.or.jp/en/pdf/policy_report/pr200703-jmd.pdf.

14. Takeshi Yuzawa, *Japan’s Security Policy and the Asean Regional Forum: The Search for Multilateral Security in the Asia Pacific* (Routledge, 2007).

15. “Economy of China, Economic Reforms” at <http://www.educationabroadnetwork.org/?id=4329>.

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Evidence pointing to potentially abundant oil and natural gas deposits has made the sea surrounding the islands a source of contention between Japan and China, the two largest energy consumers in Asia. The sea has a total area of approximately 482,000 square miles, consisting mostly of the continental shelf and the Okinawa/Xihu trough; a back-arc basin formed about 300 miles southeast of Shanghai between the two countries. Though barren, the Senkaku/Diaoyu islands become important for strategic and political reasons, as ownership can be used to bolster claims to the surrounding sea and its resources under the United Nations Convention on the Law of the Sea. A United Nations Economic Commission for Asia and the Far East (ECAFE) report in 1969¹⁶ had identified potential oil and gas reserves in the vicinity of the islands. China began exploration activities in the East China Sea in the 1980s, discovering the Pinghu oil and gas field in 1983. Japan co-financed two oil and gas pipelines running from the Pinghu field to Shanghai and the Ningbo onshore terminal on the Chinese mainland through the Asian Development Bank (ADB) and its own Japanese Bank of International Cooperation (JBIC). Only the Pinghu field, operational since 1998, has produced oil in significant quantities to date but has been steadily declining in recent years. Chinese companies also discovered a large oil and gas field group in 1995 in the Xihu/Okinawa trough. Shirabaka/Chunxiao is the largest gas field in this group and is used on occasion to reference all fields in the area. China began producing at the contested Tianwaitian/Kashi field in 2006, claiming it as part of its Exclusive Economic Zone (EEZ). China has not released production data from the Shirabaka/Chunxiao field, citing concerns about the regional dispute¹⁷.

Foreign companies have had an erratic presence in the East China Sea. In the 1990s, several foreign companies drilled a series of dry holes

16. "Senkaku Islands Dispute" at http://en.wikipedia.org/wiki/Senkaku_Islands_dispute.

17.. EIA; *East China Sea Analysis Briefs* at <http://www.eia.gov/countries/regions-topics.cfm?fips=ecs>.

in uncontested waters. In 2003, Unocal and Royal Dutch Shell announced a joint venture with CNOOC and Sinopec to explore gas reserves in the Okinawa/Xihu trough. However, Unocal and Shell withdrew from the exploration projects in late 2004, citing doubts over the commercial viability of developing energy resources in the disputed area¹⁸. In August 2012, CNOOC opened up three new offshore blocks for joint development with foreign companies in the East China Sea but has not awarded any contracts to date. What's even more interesting is that while Chinese sources predict as high as 160 billion barrels of oil and 250 trillion cubic feet of gas, the US Energy Information Administration (EIA) estimates between 60 and 100 million barrels of proven/probable oil reserves, and currently 1-2 trillion cubic feet of natural gas with some potential for further gas discoveries. From a Chinese perspective, the East China Sea does not have the deep water and logistical distance issues, making the development of any hydrocarbon resources discovered more likely. However, from a Japanese perspective, there are significant logistical hurdles for development; having to build gas pipeline infrastructure to cross the Okinawa trough would be expensive and difficult, with the gas more likely to be pumped to mainland China for processing¹⁹.

In August 2003, CNOOC signed an agreement with international energy companies Shell and Unocal to develop several gas fields in the Xihu Trough. Japanese leaders first publicly protested this agreement when a gas production facility was detected at the Chunxiao gas field in May 2004. Following rumours that production had begun at the Tianwaitian field, in addition to the high profile sighting of a Han class submarine in Japanese waters in 2004, a flotilla of the People's Liberation Army Navy (PLAN) vessels, including a Sovremenny class destroyer, was sighted near the Chunxiao field in 2005²⁰. The year, 2004 however, saw

18 Ibid.

19 Lloyd Thrall, "The Relationship between Natural Resources and Tensions in China's Maritime Periphery", April 2013, at http://www.rand.org/content/dam/rand/pubs/testimonies/CT300/CT385/RAND_CT385.pdf.

20. James Manicom, "Sino-Japanese Cooperation in the East China Sea: Limitations and Prospects", *Contemporary Southeast Asia*, vol. 30, no. 3, December 2008, pp 455-47 from <http://www.jstor.org/stable/41220523>

the beginnings of both the East China Sea conflict and the rapid ascent of the China-Japan bilateral trade relationship. In 2004 China with Hong Kong became Japan's largest trading partner; 2005 began on a bad note when Tokyo and Washington's Two-Plus-Two meeting in February 2005 issued a joint security statement that placed the Taiwan Strait under Japan-US joint defence, suggesting that Japan might intervene in a future cross-strait scenario and thus interfere in what China deemed a domestic matter. The next month, UN Secretary General Kofi Annan declared his support for adding Japan to the permanent members of the UN Security Council, which triggered a Chinese internet petition movement that opposed Japan's membership because of its alleged failure to acknowledge its wartime offences. Additional anger that the Japanese Ministry of Education had approved a supposedly nationalist textbook which glossed over Japan's war record led to the largest anti-Japanese demonstrations in China since the two countries normalised diplomatic relations in 1972²¹.

HISTORICAL MEMORY: EDUCATION AND THE NEW CHINESE AND JAPANESE GENERATIONS

Who controls the past controls the future. Who controls the present controls the past.

— George Orwell, Nineteen Eighty-Four

Historical memory manifests itself strongly in the conduct of bilateral relations between China and Japan. In East Asia, history has been the primary raw material for construction of a distinct ethnicity as the collective memory of the past serves to bind a group more strongly. In China especially, the past lives in the present to a degree unmatched in most other countries. After the Tiananmen incident in 1989, many predicted that the regime in Beijing would not last long as the official socialist ideology had lost credibility and democracy would follow. However, it was astonishing to see the Chinese Communist Party (CCP) not only recover its mandate, but also gain loyalty

21. June Tüefel Dreyer, "Sino-Japanese Rivalry and Its Implications for Developing Nations", *Asian Survey*, vol. 46, no. 4, July/August 2006, pp 538-557 from <http://www.jstor.org/stable/10.1525/as.2006.46.4.538>.

of the citizenry at a time when China was rapidly opening up to the West. Though the Chinese economy grew at more than 10 percent annually in the 1990s, only economic growth cannot answer the rapid conversion of China's popular social movements from the internal-oriented, anti-corruption, and anti-dictatorship democratic movements in the 1980s to the rise of external-oriented, anti-Western nationalism in the 1990s²². Also in stark contrast to the Generation X of the Chinese youth, the Generation Y was unwilling to criticise the Party, not in for fear of being seen as traitors but being seen as unpatriotic. As living standards in China rose and it took a greater role in international affairs, the Chinese youngsters became more or less proud of the Chinese form of government.

What we find is that shortly after the suppression of the Tiananmen demonstration, the Chinese leader Deng Xiaoping concluded that the CCP's biggest mistake in the 1980s was that the Party did not focus enough attention on ideological education. The "Patriotic Education Campaign," which began in 1991, was a massive attempt by the party at ideological reeducation. The campaign was a nationwide mobilisation effort targeted mainly at the Chinese youth. As a central part of the campaign, Beijing called upon the entire nation to study China's humiliating modern history and how much the country has been changed by the Communist revolution. The CCP drastically revised the history textbooks. In the new textbooks, a patriotic narrative replaced the old class-struggle narrative. The official Maoist "victor narrative" (China won national independence) was superseded by a new "victimization narrative," which blamed the "West" for China's suffering. The narrative of the Second Sino-Japanese War was entirely revised. The emphasis was placed on the international conflict and ethnic clashes between China and Japan highlighting all of the Japanese brutalities at the time, rather than the original narrative internal and class conflict between the CCP and KMT²³(Kuomintang).

At the same time when an entire generation of Chinese was being

22. Zheng Wang, "National Humiliation, History Education, and the Politics of Historical Memory: Patriotic Education Campaign in China", *International Studies Quarterly*, vol. 52, 2008, pp 783-806, from http://www.cctr.ust.hk/materials/library/isq_Zheng_Wang_12-08.pdf.

23. Ibid.

brought up with the “century of humiliation” narrative, with its worst years attributed to the Japanese invasion of China, the new Japanese generation was brought up with almost no knowledge or a milder version of the events in World War II history. Hence post-Cold War, when the Chinese International Relations (IR) tradition opined that Japan had never really compensated, or even apologised, for its atrocious war conduct, the Japanese were embarked on their quest to move beyond an apologetic nation and achieve normalcy in their conduct of international affairs. They desired to instill the long lost sense of patriotism in the next generation and revised their own history textbooks. While the “Three Alls Strategy of Kill All, Loot All, Destroy All²⁴” used by Japanese Imperialists in China was never accepted, words like “invade” was replaced by “advance,” the “Unit 731²⁵” deleted, and the “Nanjing massacre” changed to the milder expression of “Nanjing Incident²⁶.” Hence, while accepting the Nanjing massacre and comfort women as historical facts, the language in the history books when narrating Japan’s war-time past was toned down, with the insistence that the Chinese estimated horrendous figure of the death of 300,000 people in the Nanjing massacre was an exaggerated figure²⁷.

What is truly interesting was that when across China, businesses with connections to Japan, billboards advertising Japanese goods, and stores stocking Japanese made products were vandalised by protesters, the same year Japan became the largest overseas supplier of products to China with \$79.9 billion in exports. China’s displacement of the United States as the largest destination for Japanese exports highlighted the growing

24. “Three Alls Strategy” at http://en.wikipedia.org/wiki/Three_Alls_Policy. The strategy came to light when former Japanese soldiers released from the Fushun war crime internment center wrote a book called *The Three Alls: Japanese Confessions of War Crimes in China* in 1957.

25. **Unit 731** was a covert biological and chemical warfare research and development unit of the Imperial Japanese Army that undertook lethal human experimentation during the Second Sino-Japanese War (1937–1945). It was responsible for some of the most notorious war crimes carried out by Japanese personnel.

26. **Nanjing Massacre** also known as the Rape of Nanking, was an episode of mass murder and mass rape committed by Japanese troops against Nanking during the Second Sino-Japanese War. The massacre occurred during a six-week period starting December 13, 1937.

27. Weilu Tan, “The Forgotten History: Textbook Controversy and Sino-Japanese Relations”, BPhil Thesis, University of Pittsburg at http://d-scholarship.pitt.edu/7824/1/Tan_Weilu_BPhil.pdf.

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dependence of the world economy on China as it helped to keep the then world's second-largest economy from falling back into recession. Also by the end of 2005, Japan's accumulated investment in China had reached over US\$70 billion to make it the main source of foreign investment in China. On April 15, 2005, the beating up of a Chinese student at Beijing by Japanese foreign exchange students sparked mass demonstrations, and three days later, on Monday, April 18, the Tokyo Stock Exchange recorded a sharp plunge, sparking fears in the financial industry. Japanese Prime Minister Koizumi promptly expressed his "deep remorse and heartfelt apology" for the suffering that Japan had caused other Asian nations during World War II at the Asia-Africa Conference in Jakarta, Indonesia, on April 22. However, the moment was ruined since 81 Diet members visited Yasukuni Shrine just hours before the conference, causing even more controversy²⁸.

KOIZUMI AND THE YASUKUNI CONTROVERSY

During the 1990s, the Yasukuni controversy subsided, only to be revived by Prime Minister Koizumi who visited the shrine annually during his tenure from 2001-06. Koizumi began his visits to Yasukuni at the behest of the Izokukai, the trust foundation that manages the shrine and which was a major backer of his ruling Liberal Democratic Party²⁹. He became the second prime minister after Nakasone to visit the Yasukuni Shrine on the anniversary of the surrender by Japan in 2006. During Koizumi's tenure, relations between Japan and its primary neighbours deteriorated to the point that there were no mutual visits between Chinese and Japanese leaders from October 2001, and between South Korean and Japanese leaders

28. Scott Wilbur, "The Political Influence of Economic Dependence in Japan's China Policy since the Koizumi Administration" at <http://aacs.cuny.cuny.edu/2011conference/Papers/Wilbur,%20Scott.pdf>.

29. Yew Mang Lai, *Nationalism and Power Politics in Japan's Relations with China: A Neo-Classical Realist Interpretation* (Routledge, 2013)

from June 2005. The standstill ended when the next Prime Minister Abe visited China and South Korea in October 2006. China and Korea view the Yasukuni Shrine as disregarding the various war crimes Japan committed against them during World War II due to the enshrinement of multiple war criminals at the site. Japan on its part considers the Yasukuni Shrine as a domestic matter of paying respects to its war dead, regardless of any outside concerns.

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The Shinto Shrine has been at centre of international controversy since 1978 when 14 Class A war criminals were enshrined there. Founded in 1869 by Emperor Meiji, the Yasukuni Shrine located in Chiyoda in central Tokyo commemorates about 2.5 million war dead who died on behalf of Japan in wars from 1867-1951. Following separation of State Shinto and the Japanese government in 1945, the Yasukuni Shrine is strictly a religious affair, housing the souls of the dead spirits or *kami*, with the government having no say in who is enshrined. The Yasukuni controversy arises almost every year on August 15 and also on the Annual Spring and Autumn Festivals in April and October respectively when large group of Japanese officials visit the Shinto shrine eliciting strong condemnation from Japan's neighbours. The Japanese government answers by saying that the very separation of state and religion under Article 20, guaranteeing freedom of religion, does not allow for anyone to be prohibited from visiting and praying at the shrine. Though Shinzo Abe did not visit to the Yasukuni Shrine in his first term, he visited it in his second term on December 26th, 2013, the first anniversary of his taking office³⁰. The visit only added fire to the already strong tensions between China and Japan on the ADIZ in the East China Sea declared by China on November 23, 2013

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30. "Japanese Prime Minister Shinzo Abe Visits Controversial Yasukuni Shrine for War Dead", December 26, 2013, at http://articles.timesofindia.indiatimes.com/2013-12-26/rest-of-world/45592024_1_yasukuni-visit-yasukuni-shrine-2-5-million-war

FINANCIAL CRISES

In the first half of 2006, during Koizumi's last months in office, Japan's investment in China rose to almost 17 percent of its total outflow and eclipsed Japan's investment in the US. In September 2006, Japan's trade with China continued to increase, reaching 15 percent of Japan's exports and 20 percent of its imports in 2007. The same year, China's trade with Japan accounted for 8 percent of China's exports and 13 percent of its imports, indicating that Japan's reliance on the Chinese market had become greater than China's reliance on the Japanese market, and that commercial exchange with Japan had become a relatively less significant part of China's overall trade portfolio than previously. Moreover, in 2007, Japan's total exports and imports with China (minus Hong Kong) eclipsed its total with the US, signalling that China had become Japan's leading trade partner. On the investment side, in 2007, 12 percent of Japan's total investment occurred in China, while Chinese investment in Japan made up only one percent of the FDI in Japan, proving that China was still a negligible force in investing in Japan. Most Japanese investment in China took place in the manufacturing sector and was directed at the coastal provinces, while Japanese outlays in the service sector were more evenly divided between China and India³¹.

A sixth round of bilateral talks to deal with the East China Sea conflict in July 2006 witnessed the establishment of three technical working groups on Confidence-Building Measures (CBMs) in legal matters, a hotline agreement and resource exploitation. These developments occurred despite the fact that bilateral relations remained tense. Following the election of Abe as prime minister, and his vocal commitment to repair the relationship with China, the CBMs began to bear fruit. In July 2007, the Japan Coast Guard (JCG) and the Chinese State Oceanic Administration met in an effort to establish a hotline between the Ministry of Economy, Trade and Industry (METI's) Agency for Natural Resources and the Chinese Economic Reform and Development Commission ostensibly in charge of China's oil

31. Wilbur, n.10.

companies³². The most interesting fact here is that the seeds for these CBMs were planted prior to Abe's election, indicating a willingness somewhere in the Chinese policy-making apparatus to see past Beijing's refusal to deal with Koizumi in order to handle the island dispute issue pragmatically³³. Unlike 2003, in 2007, the Tokyo High Court upheld a lower court ruling and rejected the compensation claims of four Chinese people who were injured and one whose relative died due to exposure to chemical weapons abandoned by Japan in China at the end of the war. The court said the state was not obligated to conduct a search or to pay damages "because it cannot be said that the defendants could have prevented the outcome," with the presiding judge stating that the Japanese government was not liable for death or injury from the weapons, as it could not have conducted a proper search for weapons in another country³⁴. In 2008, further, the Japanese company responsible for removing the chemical weapons abandoned by the Japanese forces, *Abandoned Chemical Weapons Disposal Corp. (ACWDC)* was faced with a corruption scandal, forcing its closure and delaying the clean-up indefinitely³⁵.

From February 2002 to October 2007, Japan's unprecedented upward trend of 69 months was halted by the collapse of Lehman Brothers in October 2008. In the second quarter of 2008, the Japanese economy shrank 0.6 percent. US sub-prime loan crisis and surging oil prices dragged the global economy to the verge of stagnation. The global financial crisis of 2007–08, also was considered by many economists the worst financial crisis since the Great Depression of the 1930s. The slow growth of Japanese exports was mainly due to the weakened demand of the US. According to the Japan External Trade Organisation (JETRO), Japanese exports to China still grew rapidly. In the first five months of 2008, Japanese exports to China grew 24.5% compared with the year before. In April and May 2008, Japanese

32. James Manicom, "Sino-Japanese Cooperation in the East China Sea: Limitations and Prospects", *Contemporary Southeast Asia*, vol. 30, no. 3, December 2008, pp 455-47 from <http://www.jstor.org/stable/41220523>

33. Ibid.

34. Jun Hongo, "Japan off Hook for China Gas Weapons Ills: Court", March 14, 2007, at <http://archive.is/1qdB>

35. Andrew Monahan, "Japan's China Weapons Cleanup Hits a Snag", March 31, 2008 at <http://content.time.com/time/world/article/0,8599,1726529,00.html>.

exports to China grew 33.8 and 29.1 percent respectively. Hence, the external demand from China was crucial to preventing the Japanese economy from slumping into another recession³⁶. The sustained economic growth of China remains a reliable growth engine for ³⁷the Japanese economy. However as the situation recovered in 2009, there was the Tohoku earthquake in 2011 which dislocated the entire situation as supply chains were disrupted and power supplies were in shortage after the nuclear disaster.

To add further insult, Japan was surpassed by China as the world's second largest economy in last quarter of 2010. It had been world's second largest economy for 42 years after it had surpassed former West Germany in 1960. Japan's exports to China posted double-digit negative growth (year-on-year) for 10 consecutive months, from November 2008 to August 2009. This slowdown reflects a decline in Japan's exports of electronic parts and raw materials to China, as Chinese exports of finished goods to markets in Japan, the US and Europe slowed. The Chinese government announced an economic stimulus worth RMB4 trillion (US\$586 billion) in 2008, which helped China and a good part of the East Asian economy sail through the global financial crisis, but ended in overcapacity in some areas of infrastructure, and brought with it significant fiscal risks due to reckless local government borrowing, inflation, asset bubbles and the threat of bad debt following the huge credit expansion³⁸. Hence, while Japan was criticised for the 1997 Asian financial crisis, China was considered as driving the region out of economic stagnation a decade later. Also by 2008, we see the coastal region playing an even more dominant role in shaping China's manufacturing sector. In 1998, it employed more than 55 per cent of workers in the whole country, accumulated nearly two-thirds of assets and produced more than 70 per cent of output. By 2008, its shares of employment, asset and output values had all risen to more than 70 per cent³⁹.

36. Xing Yuqing, "Japan's Unique Economic Relations with China: Economic Integration with Political Uncertainty", Oct 23, 2008, at <http://www.eai.nus.edu.sg/BB410.pdf>.

37. "Japan-China Trade in 2009 Declines for the First Time in 11 years", February 16, 2010 at <http://www.jetro.go.jp/en/news/releases/20100217809-news>.

38. Peter Drysdale, "Likonomics and China's New Economic Strategy," July 8, 2013 at <http://www.eastasiaforum.org/2013/07/08/likonomics-and-chinas-new-economic-strategy/>.

39. Yue Qu and Cai Fang, "Flying geese in China", Nov 22, 2013 at <http://eastasiaforum.org/2012/11/22/flying-geese-in-china/>

THE EAST CHINA SEA DISPUTE: DETERIORATING BILATERAL RELATIONS AND EMERGENCE AS A 'FLASHPOINT'

As the Democratic Party of Japan (DPJ) was engaged in a vehement conflict in 2010 with the US to move the United States' Futenma military base, unpopular with many locals, from Okinawa, China was soon to become a saving factor in the weakening alliance. In September 2010, Japan seized a Chinese trawler and its crew after it collided with two coast guard vessels near the islands, sparking a serious diplomatic row. Small anti-Japanese protests were held in several cities in China. In the end, Japan released the trawler's crew. In the aftermath of the boat collision incident near the Senkaku/Diaoyu Islands, Chinese customs officials reportedly stopped shipments of rare earth minerals to Japan. China's halt on rare earth exports lead METI chief Kaieda Banri to criticise China's actions as a *de facto* ban and declared that it could have a very big impact on Japan's economy. || Japan was China's largest purchaser of the minerals, which have a wide variety of applications in high-tech machinery, especially in clean energy and military technologies. Therefore, the drop in rare earth shipments, which reportedly lasted until the end of November 2010 and then resumed at less than previous amounts, was keenly felt in Japan's high tech industry. Sanctions are, thus, a believable signal of resolve, and provide economically integrated countries with an alternative, peaceful way to show their commitment to national objectives⁴⁰.

In August 2012, the Japanese government's purchase of three of the disputed islands from a private landowner in order to preempt their sale to Tokyo's nationalist Governor Shintaro Ishihara sparked massive Chinese protests and a marked drop in Sino-Japanese trade. This led to military escalation in the East China Sea by both countries, leading to scrambling of fighter jets, locking of radars followed by undue display of naval warships which further precipitated suspicion rather than calming the conflict. On November 23, 2013, Chinese Air Force spokesperson, Shen Jinke announced that, "any aircraft flying through the newly designated

40. Scott Wilbur, "The Political Influence of Economic Dependence in Japan's China Policy since the Koizumi Administration" at <http://aacs.cuny.cuny.edu/2011conference/Papers/Wilbur,%20Scott.pdf>.

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East China Sea Air Defense Identification Zone must seek prior permission from the Chinese authorities in advance and follow instructions from its air-traffic controllers". He further stated, "China's armed forces will adopt 'defensive emergency measures' to respond to the aircrafts that do not cooperate in the identification or refuse to follow the instructions⁴¹". With this proclamation, the East China Sea dispute has again come into the limelight.

This sudden declaration from the Chinese side has been vehemently opposed by the US, which is a proponent of freedom of navigation in the international skies, and its security protectorate, Japan. While Japan's Prime Minister Shinzo Abe expressed his discontent by terming China's action to create a new ADIZ over the disputed islands as dangerous, US President Barack Obama also responded swiftly by sending two unarmed B-52 bombers as a "routine exercise" to fly over the new ADIZ without informing China, on November 26, 2013. The US and Japan planned to step-up air surveillance in the East China Sea, with Japan stationing E-2C airborne early warning aircraft at the Naha base in the Okinawa region and expanding the use of unmanned Global Hawk aircraft⁴². US Defence Secretary Chuck Hagel also criticised China's ADIZ openly by calling it a "destabilizing attempt to alter the status quo in the region". South Korea and Australia too have joined hands with the US and Japan in criticising China. The United States is bound by the US-Japan Security Treaty to protect "the territories under the Administration of Japan" and has asserted that Japan administers the Senkakus (Diaoyu Islands). Though Japan is assured of US help through the treaty, its anxiety remains over Washington's commitment to defend Japanese territory if it risks going to war with China.

41. "Announcement of the Aircraft Identification Rules for the East China Sea Air Defense Identification Zone of the PRC", November 23, 2013, at http://news.xinhuanet.com/english/china/2013-11/23/c_132911634.htm.

42. David Lerman, "U.S. Said Making Daily Flights into China's Air Zone", November 30, 2013, at <http://www.bloomberg.com/news/2013-11-29/u-s-said-making-daily-flights-into-china-s-air-zone.html>

The islands conflict in the East China Sea goes beyond mere questions of territorial sovereignty of three uninhabitable islands and five rocks (which, in total, amount to only 2.7 square miles in the East China Sea); clashing EEZs and continental shelves based on an inconclusive United Nations Commission on the Law of the Seas, UNCLOS, fisheries, shipping routes and logistics, uncertainty of the exact scope scale of resources in the East China Sea after the last exploration in 1968, and a derisive desire to perpetuate the conflict as a nationalist agenda building up on historical wounds and memories by both countries. China's increasing demand for energy has prompted intense interest in resource extraction from the continental shelf that runs under the East China Sea. Also the strategic shipping routes for China in the YSEB (Yellow Sea Economic Basin) catering to 57 percent of China's trade⁴³, north of the East China Sea lead to more reasons for the Chinese to want controlling interests in the islands. For Japan, its stake to those islands assumes even greater strategic importance beyond the oil and the fish as they form its first line of defence and are a mere 410 km or 220 nautical miles (nm) away from Okinawa which holds critical importance for both Japan and US.

XXX**SO WHY DO THEY 'COOPERATE' DESPITE THEIR 'CONFLICT'?**

It is truly ironical that the Sino-Japanese bilateral relationship saw one of its best phases right after China's biggest modern day debacle, the Tiananmen tragedy. Though Japan did eventually go along with other Western members and signed the G-7 joint statement issued at the July 1989 Paris Summit condemning the Tiananmen tragedy, Japan only selectively adopted sanctions implemented by other Western powers, especially the US, and worked laboriously to persuade other Western countries not to isolate China. Soon after the Paris Summit, Japan resumed its non-governmental

43. "The Yellow Sea Economic Basin- A Sea of Stars", at http://nederland.ipe.com/asia/the-yellow-sea-economic-basin-a-sea-of-stars_30583.php?articlepage=2

interaction with China. Japan officially reaffirmed its third yen loan package to China at the 1990 G-7 Summit in Houston, and started to implement it in November of the same year⁴⁴. Prime Minister Takashi Kaifu was the first G-7 leader to visit Beijing. On his visit on August 10-13, 1991, Kaifu expressed his sympathy with the Chinese views on human rights and was quoted as saying, "Clothing and food are the basis and starting point of human rights. It is an enormous progress that China can solve its problems of clothing, food, housing, and transportation (*Yi shi zhu xing*). Each country has its own cultural background, and outsiders are not in a position to judge others with their own standards. "China Announcing its decision to sign the NPT on the day Kaifu arrived in Beijing was symbolic of the importance that China attached to Japan-Chinese relations. In April 1992, Jiang Zemin returned a visit to Japan and extended his invitation for the Japanese emperor to visit China and promised that on his visit to China, the emperor would not be confronted with contentious issues such as the Senkaku Islands dispute and war reparation claims. Emperor Akihito's visit in October 1992 was the first time that Japanese emperor visited China during the two thousand-year history of the monarchy.⁴⁵

The 1972 Joint Declaration and the 1978 Peace and Friendship Treaty are the two pillars of the basic structure of the Sino- Japanese relations today⁴⁶. But the politicians who served important roles in the normalisation of diplomatic relations with China in the 1970s and in the resolution of later bilateral problems, such as Ito Masayoshi, Takeshita Noboru, Gotoda Masaharu, Nonaka Hiromu, and Kato Koichi, had either passed away or lost influence by the beginning of Koizumi's term, weakening Japan's ability at Track II and private forums to manage security issues with China⁴⁷. The 'history quarrel' has exacerbated a mutual perception of intention and provoked domestic opposition to accommodative foreign

44. Yong Deng, "Chinese Relations with Japan: Implications for Asia-Pacific Regionalism", *Pacific Affairs*, vol. 70, no.3, Autumn 1997, pp 373-391 from <http://www.jstor.org/stable/2761028>

45. Ibid.

46. OH Seunghee, "Formation of International Relations Theory in East Asia: Finding the Diplomatic Strategy of Sino-Japanese Relations in the Cold War Era", at http://wpsa.research.pdx.edu/papers/docs/WPSA_ohseunghee.pdf.

47. Wilbur, n.10.

policies. Revisions in history education stimulated the rise of nationalism and this rise of nationalism further prompted the demand for a bigger market for nationalistic agendas. We also see issues of future resource and territorial security, further prompting history to be used as a political tool to secure one's interests. However, with the possible exception of a global thermonuclear war, international politics is characterised by the expectation of future interaction. Being geographical neighbours (and also economically interdependent) China and Japan will have to *continue dealing with each other*.

Also, since both China and Japan are *intimately connected*—economically and politically—with the *United States*, the implications of the China-Japan relationship have gone far beyond the purview of bilateral relations. Any bilateral conflict between them will involve the entire globe. Further the Senkaku/Diaoyu Islands region in East Asia where important *Chinese interests and America's security obligations to Japan overlap* is a potential flashpoint that could lead to conflict between Washington and Beijing which may not be in anyone's interests at the moment. If the Asia-Pacific is the world's emerging geopolitical cockpit, the *Yellow Sea north to the East China Sea is the captain's chair*. The economic centre of gravity in the Yellow Sea Rim has, since 1990, shifted from Kobe to Pusan, and then from Pusan to Shanghai and China's northeast coast. Six of China's 10 largest commercial ports can be accessed only via the East China Sea. *China will not want to risk aggravating war so close to its economic heartland*. Barack Obama's shifting American military and diplomatic "pivot" or "*US rebalancing strategy*" to the Asia-Pacific puts China into a greater international spotlight. At this critical juncture, China would not want its any action against Japan to be seen as *threatening and disrupting the region unilaterally*, leading to further strengthening of the US camp.

China and Japan may be big powers competing in the region, but their toughest challenges are themselves. Both face *numerous domestic challenges*: be they problems of demography, political dissension, economic, environmental issues, etc. 'Economic growth' is a major source of legitimacy for governments in East Asia. East Asia is world's most populous region (1/5th of the world's

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total population) and contributes to 25 percent of world Gross Domestic Product (GDP). For the CCP to continue on with its mandate-to-rule, it needs to keep the momentum of growth going in China at all costs. Rapid economic growth is essential for both Chinese domestic stability and its international standing. In the case of Japan that has yet to recover from its long-standing economic stagnation, Shinzo Abe also needs to deliver on his economic promises to remain in office. Also,

in deciding between peace and war in the China-Japan relationship, we cannot only refer to economic interdependence. It's not the expected value of trade at a particular moment in time, but the *expectations of trade levels to be high in the future*, that has led them to assign a higher premium on trade, making war the less appealing option. *Mutually assured production*, the economic version of mutual deterrence, has led China and Japan to be accommodating on their points of conflict despite the historical baggage, especially since the beginning of the new millennium. In 2008, when the US sub-prime crisis and surging oil prices dragged the global economy to the verge of stagnation, the Chinese government announced an economic stimulus worth RMB 4 trillion (US \$586 billion) which helped China and a good part of the East Asian economy to sail through the global financial crisis⁴⁸. While demand from the US slowed, Japanese exports to China still grew rapidly. External demand from China was crucial to preventing the Japanese economy from slumping into another recession.

China and Japan are the world's second- and third-largest economies. Not only are they both *economically interdependent* on each other with both being major export-destinations for each other, but are *heavily intertwined in the East Asian regional production networks*. For most countries in the region, trade in components and parts accounts for well over half of total network exports (imports). Japanese businesses have extremely high stakes in China

48. "Chinese Economic Stimulus Program" at http://en.wikipedia.org/wiki/Chinese_economic_stimulus_program

and, hence, expect to continue to work there despite antagonistic moves by both governments. In the words of Hori Toshio, general manager of the Tokyo-Mitsubishi Bank branch in Shanghai, "The relationship is too big for withdrawal already". Aside from the marginal sway of Keidanren on Koizumi's 2005 Yasukuni visit and the fruitless overture by the Doyukai in 2006, there is little evidence of the Japanese business community attempting to moderate the behaviour of Japan's political leaders, either during or after Koizumi's term. The few other attempts at limitation that appeared in the Koizumi years seem to be aimed only at Koizumi's Yasukuni visits, not at other aspects of Japanese policy that related to China and were met with strong domestic resistance, sometimes of a nationalistic character. For example, when Fuji Xerox Chairman Kobayashi Yotaro declared in September 2004 that Koizumi's Yasukuni visits were hurting Japan's business in China, he was pilloried by right-wing groups and sent an intimidating letter containing live bullets. Days after Koizumi's final trip to the shrine in August 2006, the Japan-China Friendship Association President and LDP House of Representatives member Kato Koichi had his house burned down by a nationalist extremist who disagreed with Kato's criticism of Koizumi's shrine visit.

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In 2010, foreign companies and joint foreign-Chinese ventures accounted for more than 25 percent of China's entire industrial output, 39 percent of its apparel exports, and 99 percent of its computer exports. And these companies rely on imports from Japan. China cannot single out Japanese products without damaging and alienating the network of multinational companies that are fuelling China's march up the value chain and toward higher living standards. Around 60-70 percent of the goods China imports from Japan are the machinery and parts needed to make China's own products. China cannot cut off this flow, or risk disrupting it through conflict, without crippling its economy. Japanese firms know this, which explains why they are not fleeing despite the recent tensions. In a survey

conducted by JETRO in 2012, just after the spate of violence, only 6 percent of Japanese companies in China said they were going to leave or downsize, 52 percent planned on expand, and 42 percent indicated that they would keep their operations at the same level while monitoring the situation. Japan remains the largest source of foreign investment in China today. In 2012, a year in which global foreign direct investment in China fell by 3.7 percent, Japanese investment rose by 6.0 percent. According to Masaki Yamazaki of the Japan Centre for Economic Research, some Japanese firms are considering a “China plus one” strategy, a way of diversifying their risks and finding another large market to invest in and export from. But, he added, “It’s unrealistic to think that all the Japanese companies will rush away from China.” What is more, China’s bulging middle-class market is too big to be ignored by Japanese companies that produce consumer products and are plagued by low growth at home⁴⁹.

“We can conclude with the thought that although money may be the root of all evil, maybe it will bring peace to East Asia.”

49. Richard Katz, “Mutually Assured Production: Why Trade Will Limit Conflict Between China and Japan”, *Foreign Affairs*, July/Aug 2013 from <http://www.foreignaffairs.com/articles/139451/richard-katz/mutual-assured-production>