

# Japan and China: Bitter Rivals and Close Partners

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Japan and China trade a lot between each other. Unfortunately, however, they also argue a lot with each other. Since Tokyo's purchase of three uninhabited Japanese-controlled islets in the East China Sea from their private owner in September 2012, the main subject of dispute has been that of sovereignty over maritime territories. While bilateral trade amounted to an impressive \$333 billion in 2012 (slightly less than in 2011, when bilateral trade reached \$345 billion), a bilateral territorial dispute over control and sovereignty of what Tokyo calls Senkaku and Beijing calls the Diaoyu Islands will most probably continue to remain at the very top of the agenda of Sino-Japanese relations in the months ahead.

After a partial boycott of Japanese goods and products in China immediately after the Sino-Japanese diplomatic crisis broke out in September 2012, trade relations have recovered in the first quarter of this year. Late last year, when anti-Japan demonstrations in China, some of which culminated in violence, cast doubts upon the sustainability of Japanese investments and production in China, Japanese carmakers and electronic companies feared that they would have to shift production out of China. Concerns in this respect have much reduced now, six months later.

From September to December 2012, Japanese investors in general and carmakers in particular felt the impact of the bilateral political crisis. Toyota's sales fell by about 30 per cent in a few weeks and while Japanese automakers' share on the Chinese market accounted for 23 per cent in September 2012, it dropped to 14 per cent in two following months. Toyota, however, is confident that it will not only return to pre-crisis sales but even expects this year's car sales in China to exceed the previous year's. While Toyota announced earlier this year that its

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sales in China had recovered to 84 per cent of the pre-crisis level, the carmaker expects to sell 900,000 cars in China in 2013. This would pass the mark of its best-ever annual sales of 890,000 units.

The Sino-Japanese crisis certainly is far from over and there is a near-consensus amongst analysts that inability of Japan and China to let political common sense and diplomacy prevail over nationalism and historical revisionism may easily result in another September 2012-style boycott of Japanese products at any time in the months ahead. This time around, however, Japanese investors in China are probably better prepared to deal with the consequences of intensifying bilateral political tension. Japanese investors have learned their lesson from the over-exposure to the Chinese market and are accelerating a diversification of their investment strategies in Asia in general and Southeast Asia in particular.

### Japan Buys, China Gets Angry

On September 11<sup>th</sup>, 2012, the Japanese government, led by prime minister Yoshihiko Noda at the time, bought three of the islands under dispute (Minami-Kojima, Kita-ujima, and Uotsuri islands) from their private owner for roughly \$26 million. Although Beijing begs to differ (very strongly), Noda maintained at the time that the purchase did not change but instead maintained the status quo after Tokyo's nationalist and China-bashing former governor Shintaro Ishihara announced to purchase the islands on behalf of Tokyo's municipal government earlier in 2012. Ishihara, a politician infamous for his track record of white-washing Japanese World War II imperialism, hardcore nationalism and inflammatory anti-China rhetoric announced to deploy personnel to the islands and build a small port and other facilities there. Japan's official position is not to allow anybody – neither private citizens nor government officials – to set foot on the islands and Noda feared that allowing Ishihara to buy the islands would have further worsened the already tense bilateral relations. Conse-

quently, the Japanese prime minister decided to buy those islands for the purpose of “maintaining those islands in a calm and stable manner”, as he put it. That message, however, did not reach Beijing, which arguably only heard what it wanted to hear. Indeed, from a Chinese perspective it was completely irrelevant who in Japan bought the islands – the purchase was a change to the previous status quo as far as Beijing's leadership was concerned.

Indeed, what came after the purchase of the islands was everything but calm and stable. Interpreting the Japanese government's decision to purchase the islands as a unilateral change to the status quo, China turned to seeking to change the territorial status quo in the waters and airspace around and above the Senkaku/Diaoyu Islands. In addition to increasing the number of naval law enforcement patrols close to or in Japanese-controlled waters, Chinese reconnaissance planes repeatedly intruded into Japanese-controlled airspace (where they were at least once scrambled by Japanese F-15 fighter jets). On January 30<sup>th</sup>, 2013, Japan and China came fairly close to a military clash when a Chinese naval frigate directed weapons-targeting radar at a Japanese destroyer in waters off the disputed islands – a move typically considered to be one step away from opening fire.

### Japan Controls Them, China Wants Them (Back)

While Beijing's territorial claims to the islands go back to the 14<sup>th</sup> century, Japan – with an interruption from 1945-1972 – has controlled the Senkaku/Diaoyu Islands since 1895 after its victory over China in the 1894-1895 Sino-Japanese war and the adoption of the Treaty of Shimonoseki. Although the Treaty of Shimonoseki did not specifically mention the Senkaku/Diaoyu islets, Beijing argues today that they were ceded to Japan as part of Taiwanese territory in 1895. Consequently Japan was – at least from a Chinese perspective – obliged to return the islands to China when Tokyo ceded sover-

eighty over Taiwan back to China through its signature of the 1951 San Francisco Peace Treaty.

Japan, on the other hand, argues that the islands were what international law calls “terra nullius”, i.e. territory over which sovereignty was never claimed by a state, in 1895. According to Japan, the islands did not belong to Taiwan and were hence not ceded to Japan under the Treaty of Shimonoseki. Instead, Japan incorporated them into Japanese territory as “terra nullius” months before

the adoption of the treaty. China further maintains that the Potsdam Declaration (July 26<sup>th</sup>, 1945) obliged Japan to renounce control of all islands it had annexed in the 19<sup>th</sup> and 20<sup>th</sup> century, including the Senkaku /Diaoyu Islands. Tokyo disagrees, pointing out that neither the Potsdam Declaration nor the San Francisco Peace Treaty specifically mention the islands.

Article 3 of the San Francisco Peace Treaty then put the disputed islands under the administration of the Unit-

**Figure 1: Disputed Islands**



Source: Own illustration



ed States as part of the Ryukyu Islands (also referred to as Nansei Shoto Islands). The United States administrated the islands as part of the United States Civil Administration of the Ryukyu Islands from 1945 to 1972, when Washington reverted the islands to Japanese control under the US-Japan Okinawa Reversion Treaty of 1971. While China maintains that the disputed islands do not even belong to the Ryukyu Islands today, it did not express any objections to the disputed islands' status of being under US administration from 1945–1972.

### No Compromise in Tokyo ...

Japan's prime minister Shinzo Abe is – due to his nationalist and at times historical revisionist track record, revisiting Japan's aggressive and imperialist behavior during World War II – arguably not the most suitable politician in charge to deal with the bilateral territorial dispute calmly. Japan's business elites have actually urged Abe and like-minded nationalists in his cabinet to suppress their nationalist instincts and take Japanese business interests in China into account several times in the last six months.

Such a reminder to Japan's leaders seemed necessary as Abe did not only limit himself to refer to Japanese control and sovereignty over the disputed islands as “non-negotiable”, but also flirted with the idea of deploying government officials to the islands. While Japan insists that there is no territorial dispute with China in the East China Sea to begin with, Beijing wants Tokyo to reconsider. “Beijing wants Tokyo to back off and admit that there is disputed territory with Japan,” Tiejun Zhang, Associate Senior Researcher at the Centre of Non-Traditional Security at Zhejiang University in China points out.<sup>1</sup>

Which, as a Japanese analyst confirms, is what Japan will not do.<sup>2</sup> “The government will never acknowledge the existence of a territorial dispute over the Senkaku Islands with China and will not negotiate on sovereignty over them. China's territorial claims are almost nonsen-

sical in light of the historical evidence.” Tokyo, however, he adds, “is nonetheless prepared to let the International Court of Justice (ICJ) rule on the dispute. Given that Japan already controls and administrates the islands, it does not have to ask for ICJ arbitration. Normally those who want to regain control and change the status quo should go to the ICJ first.”

### ... and “Core Interests” for Beijing

China's new leadership under Xi Jinping, of course, won't do that and instead has turned to referring to the disputed islands as belonging to what Beijing calls China's “core interests”. “Core interests” describe issues related to national sovereignty and territorial integrity over which Beijing is (very) determined not to compromise over. While this term has typically been used in reference to Taiwan, Tibet and the Xinjiang Uygur Autonomous Region in the past, disputed territories in the South China and East China Sea are now also territories China is determined to defend under all circumstances.

“China's ‘core interests’ are more important than anything else,” Zhang confirms. “China's leadership feels that it can continue to put pressure on the Japanese government through intrusions into Japan-controlled territorial waters,” he says, adding that Xi is de facto obliged to opt for hard-line policies on territorial disputes. “Xi Jinping cannot appear to be weaker than his predecessor Hu Jintao where the territorial disputes are concerned, especially considering that his power base in the party is not as consolidated yet.”

Others in China deny that Chinese assertiveness on disputed territories in the South and East China Seas is a result of China's leadership transition. “I do not buy into the speculation that the new leadership needs to exhibit assertiveness to prove its legitimacy or secure its power base. Contrary to what outsiders may think, the government is trying to calm, not to inflame, the Chinese

<sup>1</sup> In an interview with the author on May 19<sup>th</sup>, 2013.

<sup>2</sup> In interview with the author on May 15<sup>th</sup>, 2013. The scholar – in view of his affiliation and his institute's close links with a government ministry – requested not to be identified.



people's nationalism," a Chinese scholar<sup>3</sup> tells the author in an interview. Then again, he adds: "While a military solution to territorial disputes is only China's last resort, China will not accept to be indefinitely pushed around by its smaller neighbors." As long as Beijing does not consider deploying armed forces to deal with the territorial dispute," however, a military conflict with Japan over the disputed islands remains unlikely," he concludes.

### "Dual Control" Chinese-style

While Japan (and admittedly many others in Asia, too) considers Chinese intrusions into waters controlled by it as evidence that China is using its growing military power to claim disputed territories all over Asia, Beijing continues to argue that there isn't anything wrong with intruding into Japanese-controlled territorial waters as Chinese Lieutenant General Qi Jianguo, deputy chief of general staff of the People's Liberation Army (PLA) confirms during the annual Shangri-La Asian Security Summit in Singapore in June: "Our attitude on the East and South China Seas is that they are defending Chinese sovereignty. Chinese warships patrolling the South China Sea and East China Sea is entirely legitimate and uncontroversial."

These patrols and violations of Japanese-controlled waters have – at least from a Chinese perspective – become effective. "China has successfully transformed Japan's "nationalization" of the three islands into an opportunity to gain actual control over the Diaoyu Islands, making "dual control" over the islands the new reality," a Chinese scholar<sup>4</sup> tells the author in an interview. From a non-Chinese perspective, this is arguably a legally and politically highly questionable approach: Intruding into waters controlled by another country and labeling such intrusions "dual control" has not been acknowledged as such outside of Chinese policy-making circles, let alone in Japan, since 1895. Deterring Chinese vessels from

violating Japanese territorial waters, a Japanese analyst says in an interview with the author<sup>5</sup>, is certainly becoming increasingly difficult. "The mission of defending the Senkaku Islands is very demanding and we are seriously concerned about how long the country's coast guard and Japan's Maritime Self-Defense Forces (JMSDF) can keep the current operational tempo around the islands."

### Win-Win Business Ties

In sharp contrast to the tense political and diplomatic ties, trade and investment relations are soaring in spite of the setback late last year. Bilateral Japanese-Chinese trade has more than tripled over the past decade, making China Japan's largest trading partner now, accounting for 21 per cent of Japan's exports and imports.

Japanese investments in China are more than twice the combined investments of the US and South Korea in China. According to recent data from the Japan External Trade Organization (JETRO), Japanese exports to China fell for the first time since 2009 in 2012, dropping by 10 per cent to \$144.7 billion. Japanese imports from China on the other hand increased by 3 per cent to \$188.9 billion. While the bilateral trade volume dropped to \$333.6 billion in 2012 (down from \$345 billion in 2011), JETRO expects exports to China to grow in single percentage digits while it forecasts a 10 per cent growth in imports from China. The \$345 billion in bilateral trade in 2011 amounted to 9 per cent of China's overall trade and was more than China traded with Brazil, India, Russia and South Africa and Britain combined.

Japanese companies have made foreign direct investments in China amounting to \$12 billion in 2011 according to Japanese data (data from non-Japanese sources put the number of Japanese investments in China at \$6–7 billion). Since 1996, Japan has accumulated \$83 billion in investments in China. According to Keidanren, Japan's biggest business association, roughly 30,000 Japanese

<sup>3</sup> Who requested not to be identified by name.

<sup>4</sup> Who requested not to be identified by name.

<sup>5</sup> An analyst with close links to a government ministry and requested not to be identified by name.



companies are operating and investing in China, employing 10 million Chinese workers. Chinese outward investments into Japan, on the other hand, are yet very modest and have amounted to \$560 million in 2011. In comparison, US companies have invested \$70 billion, and EU companies \$94 billion in Japan in the same year.

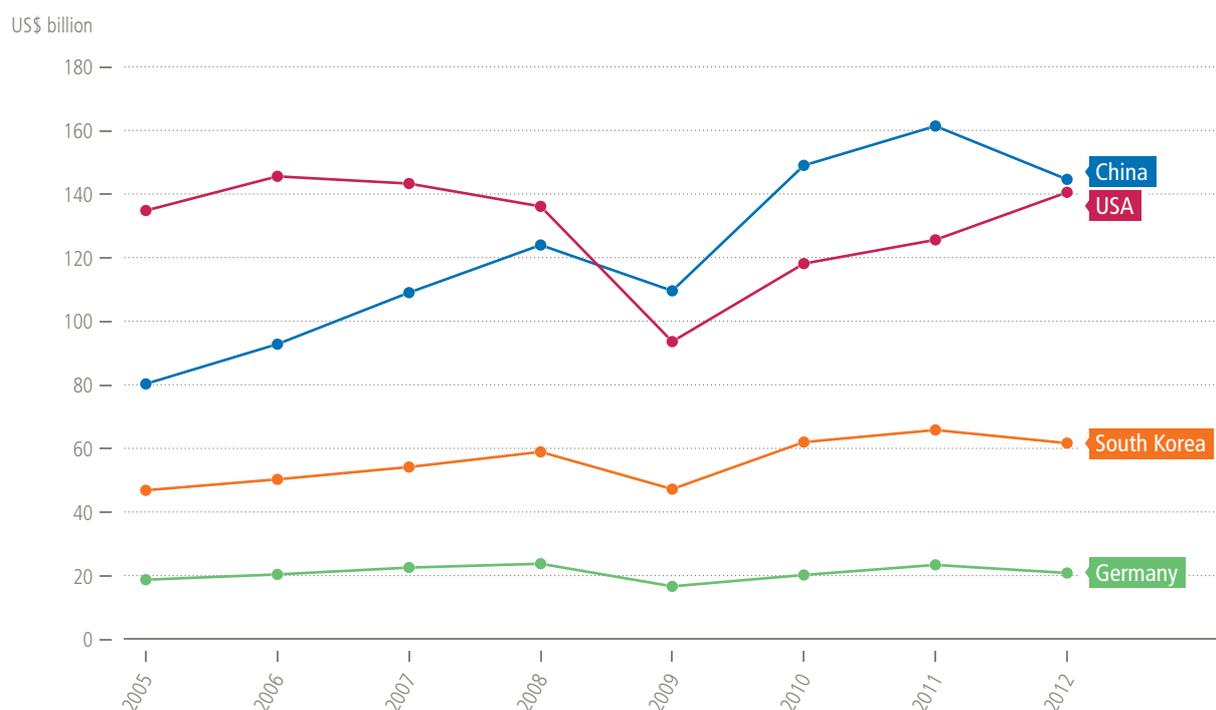
### Partners and Competitors

While Japanese brands and products are highly visible on China's domestic market, Chinese consumers have proven late last year that they are prepared to shun Japanese brands as an expression of what the authorities referred as Chinese 'patriotism' back then. To be sure, China has much to lose from a September 2012-style boycott of Japa-

nese products as well. Most of Japanese products are produced and assembled by Chinese-owned companies with local labor and materials.

Japan and China hold complementary roles in the east Asian production network: while China is the leader of Asia's assembly and production network, a great many components of advanced technologies are imported from Japan. The Japanese-Chinese complementarity is, of course, limited as China is improving its ability to operate in the high(er) ends of the technology spectrum as well. Rising Chinese wages, the (yet relatively slow) appreciation of the renminbi and a shrinking labor force have obliged Chinese companies to compete at the higher end of the value chain. Furthermore, massive investments into the country's in-

Figure 2: Japan's exports to major markets



Source: Japan External Trade Organization (JETRO)



infrastructure and technological capacities have enabled Chinese companies to strengthen their position in more skill-intensive industries.

While China is on its way to establishing itself more and more as an economic competitor of Japan, both countries are already competing globally for access to resources ranging from hydrocarbons to base metals. Finally, China's near-monopoly global position in rare earths, vital to Japan's more sophisticated production lines, makes Japan economically very vulnerable to an interruption of Chinese rare earth exports.

### What next?

The bilateral territorial dispute is arguably an enormous waste of time and resources, potentially jeopardizing mutually beneficial and profitable trade and business relations. For the time being, Beijing seems to feel strong and invulnerable enough to defend its "core interests" and let political and economic common sense dominate its decisions related to the territorial dispute with Japan that started 118 years ago.

Although Beijing thinks it has already established "dual control" in disputed waters in the East China, Chinese intrusions into Japanese-controlled waters do in reality not change the actual control over the disputed islands and the waters surrounding them. Unless, of course, the Chinese military gets the go-ahead to take over and (mis)manage the conflict to establish the above-mentioned "dual control" or worse – from a Japanese perspective – "exclusive control" through military force.

The territorial dispute certainly is not only about nationalism and transition of leadership in Japan and China, says US Japan scholar Michael Green in an interview with the Financial Times: "About 90 per cent of Japanese and Chinese oil and gas is shipped through those waters, while dominance above the sea helps both sides map the topography beneath the sea for submarine warfare. That makes the Senkaku Islands dispute an en-

during structural problem, one that goes beyond nationalist disturbances or political transitions in China and Japan," Green concludes.

As for the good news, China and Japan have agreed to seek to start negotiating a bilateral free trade agreement despite the on-going territorial conflict earlier this year. However, there is probably next to no doubt that the territorial dispute will affect the speed with which Tokyo and Beijing will actually be able to adopt such an agreement.

Before nationalism and historical revisionism made unhelpful comebacks on Japan's and China's respective domestic policy agendas, Tokyo and Beijing had some constructive ideas on how to deal with the territorial dispute. In 2008, Tokyo and Beijing signed a memorandum of understanding envisioning the joint exploration of natural resources in the East China Sea – an attempt at adopting what was referred to as 'functional cooperation' while (silently) agreeing to disagree on whom the islands belong to. Such 'functional cooperation', however, is currently everything but completely off the bilateral agenda.

In view of the de facto refusal in both Tokyo and Beijing to talk to as opposed to about each other regarding the disputed islands, they are advised to focus on what they do best: trade bilaterally while ordering their respective coast guards and navies to limit themselves to 'observing' each other in the East China Sea.



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