

THE ORIENTAL ECONOMIST

ALERT

PUBLISHED BY JAPAN WATCHERS LLC

December 11, 2013

TOUGH ON JAPAN ON SECURITY; SEEKS MORE TRADE, INVESTMENTS PRC DELINKS ECONOMICS FROM POLITICS, PART 1

Key points:

- **Vis-a-vis Japan, China is delinking economics from politics**
- **It is steadily escalating on the Senkakus dispute, e.g. its declaration of an ADIZ including the Senkakus, while at the same time seeking to increase trade and investment**
- **High-level Chinese missions have gone to Japan to seek more investment**
- **High-level Japanese business missions have gone to China and received favorable press coverage**
- **Some of the Chinese coverage argues that these Japanese business leaders are trying to pressure Abe to ease his hardline stance, but say they have had little success so far**

Overview

When it comes to Japan, Beijing is blowing hot and cold. On security issues, it seems to get tougher and tougher. Yet, when it comes to economic ties--whether it be imports from Japan or seeking more foreign direct investment (FDI) from Japanese companies—China is quickly restoring normal ties. This is a big reversal of the riots and boycotts that spread across China beginning in the summer of 2012 after then-Prime Minister Yoshihiko Noda bought some of the Senkaku Islands from their private Japanese owner. When a top-level Japanese business delegation visited Beijing in November, China's TV network, CCTV, reported, "Putting aside their countries' diplomatic deadlock, the two sides are seeking better economic ties."

In short, what we see is a delinking of economics from politics. China appears to have

given up on the idea that it can use Japan's dependence on China as a market in order to wrest concessions on territorial and other disputes.

China's ADIZ

Beijing's latest security-related gambit is to declare a so-called Air Defense Identification Zone (ADIZ) over an area that includes the Senkaku Islands (called Diaoyu by China), as well as an island long controlled by South Korea. They have announced that all aircraft flying through the ADIZ must inform China of their plans in advance and respond to instructions from Chinese aircraft—or face the consequences.

China justifies its ADIZ by noting that 20 other nations, including the US and Japan, also have ADIZs. But there are some critical differences. First of all, by including the Senkakus, China is clearly using this as additional pressure to get Japan to say that the territory is under dispute. Secondly, the ADIZ not only overlaps Japan's ADIZ but includes gas fields that are in dispute (see *Figure 1* for map). Thirdly, unlike the US and Japan, China is applying its policy not only to airplanes that intend to land in China, but also to aircraft, including civilian aircraft, that are simply flying through international air space that China chooses to include in its ADIZ. In the event, China has not actually scrambled any jets when other countries have sent their military aircraft through the new ADIZ, despite claiming to have done so.

There is another difference. The ADIZ is clearly part of China's effort to establish its dominance over large parts of the East China and South China Seas. Beijing has announced it may soon announce an ADIZ for the South China Sea, most of which China claims it owns.

Moreover, according to a recent *Wall Street Journal* article, Chinese aircraft and vessels have chased off archeological explorations in the South China Sea, including one incident near the Philippines, on the grounds that China owns area. China reportedly has established a high priority to doing its own explorations as a propaganda aid to its territorial claims. "We want to find more evidence that can prove Chinese people went there and lived there, historical evidence that can help prove China is the sovereign owner of the South China Sea," Liu Shuguang, head of the Chinese government's Center of Underwater Cultural Heritage, told the *WSJ*.

In response, the US and South Korea sent a few warplanes through the zone; Tokyo instructed its civilian airlines not to give China their flight plans if they are not landing in China (while the US told US airlines to avoid risk by announcing plans to China); and South Korea has expanded its own ADIZ to include the rock it controls and which China claims and put in its ADIZ.

Moreover, Seoul notified both Washington and Tokyo in advance of its declaration. It

also said that it would hold talks separately with Japan and China to prevent accidental clashes that might occur as a result of overlapping ADIZs. Civilian airlines will not need to resubmit their flight plans to Seoul after the expanded zone takes effect. Japan and South Korea already report to each other prior to Japan's Self-Defense Forces (SDF) and South Korean military planes entering each other's ADIZ. They are reportedly considering further talks to make sure there is no accident between Japanese and Korean aircraft in their overlapping air zones. Since the ADIZ is not a territorial claim in any legal sense, Japan's ADIZ does not include Takashima Island, which South Korea has long controlled but Japan also claims.

China reacted in surprisingly mild terms to Korea's action. An article in *The Diplomat*—a newspaper founded in Australia but now published out of Tokyo--commented, "China remains cautiously accepting of South Korea's latest move. This is a testament to the relative strength of China-ROK relations. However, it also serves to highlight a point that China has repeatedly denied, that the new ADIZ is aimed straight at Japan."

PRC Officials Go To Japan To Seek More Investment

While China talks, and acts, tough on these territorial-military issues, it is speaking and acting in far more soothing tones when it comes to economic ties. As we've stressed before (see *Alerts* series from February 2013 on "Economic Fallout From Senkakus Dispute"), China needs Japan just as much as Japan needs China. China's own exports hinge on parts coming from Japan (e.g. the Toshiba flash drives used in the i-Phones assembled in China). Chinese provinces worried about an economic slowdown want the jobs, investment and technology transfer that comes from more and more Japanese firms setting up facilities in China (see March *TOE*).

So, although the process is slow, Japan-China economic relations appear to be normalizing. And Chinese officials and firms are now openly acting to normalize it even faster.

They are particularly interested in wooing more investment from Japan and preventing any trend by Japanese firms to shift from China to other countries in Asia for their export bases.

In October, executives from ten leading Chinese companies have visited Japan and had meetings with Chief Cabinet Secretary Yoshihide Suga, a key Abe administration power broker, as well as Hiromasa Yonekura, the head of the Japan Business Federation Chairman. They were sent from Guangdong Province (Canton) on a mission to promote investment by Communist Party Secretary Hu Chunhua, who looks likely to join the ranks of elite Chinese leaders in the future. A Chinese official told the 120 Japanese companies in attendance that Japan is China's "most important trade and investment partner." According to *Nikkei*, the mission had to submit its

proposal to visit Japan to the Communist Party leadership three times before receiving approval. They were finally told they could meet with anyone they wanted to—except for Prime Minister Shinzo Abe.

Meanwhile, Yonekura headed an economic mission to Beijing in November and was received by Vice Premier Wang Yang, who presides over China's foreign economic relations. The Japanese group hoped to meet with Chinese Premier Li Keqiang during their visit but could not. Former Chinese ambassador to Japan Xu Dunxin told the Chinese press, "This visit is still significant for strengthening bilateral economic and trade ties between China and Japan. We hope the communication between high-profile business entrepreneurs will help result in a turnaround of the strained China-Japan relationship."

In October, 70 Japanese companies and municipalities took part in the Western China International Fair, in Chengdu, Sichuan Province. This was the province struck by the disastrous earthquake of 2008. Last year, as anti-Japanese riots hit Chengdu streets, the Japanese company booths were removed from the fair. This year, not only did the organizer actively seek Japanese participation, but Sichuan Governor Wei Hong got JETRO (Japan External Trade Organization) to open an office there. Similar events have occurred in other provinces.

Some Chinese Leaders Think Economic Pressure Can Leaven Abe's Stance

Some Chinese analysts argue that improved economic ties will help lessen the friction over the Senkakus by putting more pressure on Abe. If this view is accepted by the Chinese leadership, it would indicate—not a delinking of economics from politics—but rather a link that has switched from the stick to the carrot. For example, in its coverage of the Yonekura mission to China, the Communist-Party owned *China Daily* wrote:

More than 100 influential Japanese entrepreneurs are visiting China in search of business opportunities brought about by Chinese economic reforms, and they appear to be increasing pressure on the hard-line Japanese prime minister to rein in his government's hostility toward China.... The Japanese entrepreneurs have come to "seek a turnaround of the China-Japan relationship and bring an end to the already lose-lose situation," said Zhang Jifeng, from the Institute of Japan Studies at the Chinese Academy of Social Sciences... "Bilateral trade is still far from returning to normal, despite the positive signals sent out by the latest statistics and economic indicators," Zhang said.

Jiang Ruiping, an expert on the Japanese economy and vice-president of China Foreign Affairs University, said Japanese businessmen demonstrated a willingness to thaw the relationship when the political deadlock started, but Abe and key cabinet members have continued their aggressive posturing toward China... "The big shots of Japanese industry are visiting China on such a large scale to increase pressure on

the Abe Cabinet to refrain from provocations. But we cannot place too much hope in the subsequent lobbying in Tokyo because the politicians are now acting quite independently from the business advisors,” Jiang said...

“The Japanese industrial players do not want to lose out on a piece of China’s economic cake and they are wondering where China is heading,” he said.

One of the aims of the Japanese visit is to encourage demand from China, because the Japanese economy has suffered “an increasing trade deficit,” while at the same time the Japanese yen continues to depreciate, said Xu Changwen, a research scholar with the Chinese Academy of International Trade and Economic Cooperation under the Ministry of Commerce. “The right-wing mentality is spreading within Japanese domestic politics, and Japan has worsened its relations with its neighbors due to historical and territorial issues, which further impacts on the economic indicators,” Xu said.

Despite this, we are more inclined to the “delinking” view rather than the “carrot vs. stick” view: Beijing feels it can simultaneously step up security pressure while normalizing economic ties that are in China’s own interests (of course, our expertise lies in Japan, not China).

More Top-Level Gatherings

Some Japanese observers say that Beijing’s attitude on economic matters changed around the time of the annual secretive Beidaihe meeting of top Chinese leaders, held in Hebei Province. It was the first such meeting hosted by Xi Jinping since he took power. However, in our view, Beijing’s move to normalize economic relations began much earlier, at the end of 2012, and the Beidaihe and subsequent meetings are further steps along the same road.

One of our correspondents in Tokyo, Yoshisuke Inuma, points to a November meeting:

A private Japanese organization called The Genron NPO and Chinese Communist-Party owned newspaper, *China Daily*, hosted their usual annual two-day conference in Beijing that touched on political and security issues. Nearly 1,000 people attended, including Japanese and Chinese politicians, former bureaucrats, former military officials and other key people, as well as journalists. They held frank discussions about each side’s claims and adopted a “Beijing Consensus” that calls for both sides to avoid taking any actions that could lead to war and to begin discussions about the dispute over the Senkakus.

While it is noteworthy that private interests traded earnest dialogue, the fact that the Consensus mentioned the prevention of war speaks to the seriousness of the dispute. In sessions on security, defense researchers and former military officials from each side discussed topics such as the need to build crisis management mechanisms between defense authorities and the need to hold discussions between the countries’ military officials and have military experts deliver appropriate

information to counter hyper-sensitive reporting by the media.

We have noticed since that meeting a number of articles in the English-language *China Daily* that portray Japan, or the Japanese people—as distinct from PM Abe—in a favorable light.

In its November 15 edition, *China Daily* reported:

What a difference an ordinary person can make at a time when China and Japan are mired in the worst diplomatic deadlock since 1972.

Yan Jun, a 26-year-old Chinese student majoring in economics in Osaka, has melted the hearts of some Japanese people, if not the ice of bilateral relations. His story is unusually good news amid the strained ties.

After risking his life to save a nine-year-old Japanese boy who was drowning in Osaka on Sept 16, Yan was presented with a certificate of gratitude by Japanese Prime Minister Shinzo Abe at his official residence in Tokyo on Wednesday.

In a commentary in *China Daily* on the same day, Yang Bojiang, deputy director of the Institute of Japanese Studies at the Chinese Academy of Social Sciences, wrote:

If the China-Japan relationship breaks down, neither can afford to bear the strategic cost.

To break through the stalemate in relations and push bilateral ties back onto a positive track, the key in the near term is to enhance cooperation, reduce confrontation, and properly handle the issues in bilateral relations. It would be advisable to promote cooperation on some energy saving and environmental protection projects, so the two peoples can focus more on the overall advantages and benefits of better China-Japan relations. This would create a more conducive public opinion environment for the improvement of relations.

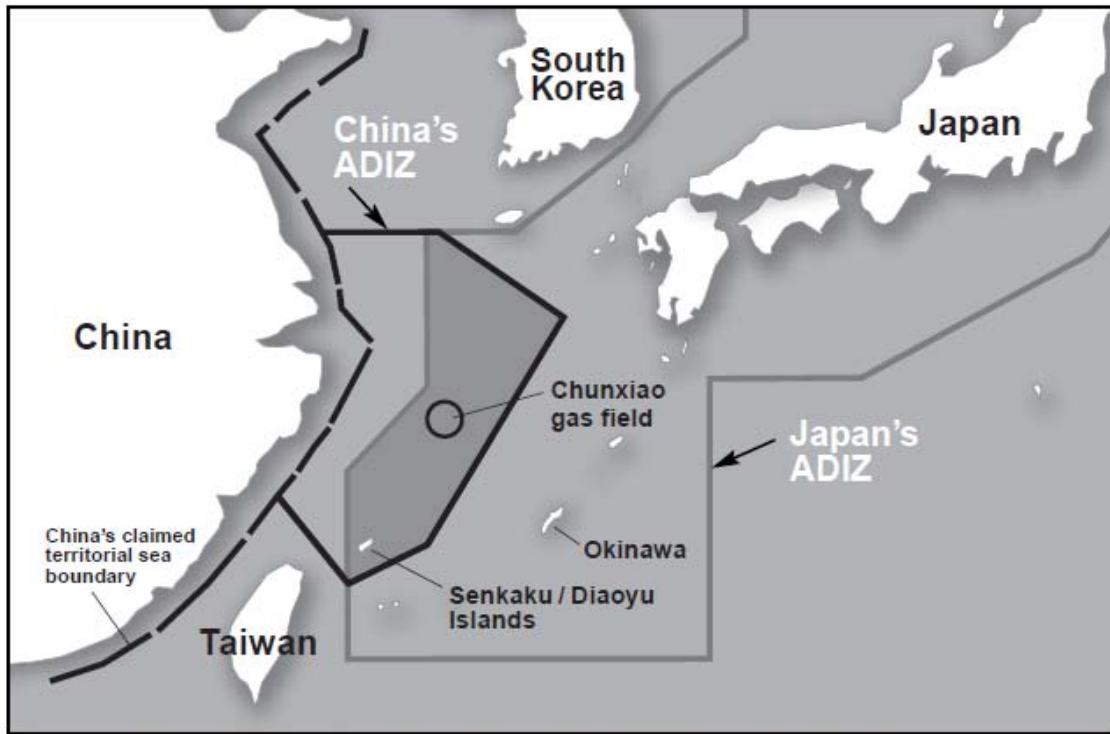
Meanwhile, the two countries should step up negotiations to establish a maritime crisis management and control mechanism in a bid to prevent inadvertent clashes in the East China Sea.

However, the premise underlying any efforts and measures to improve relations, including high-level dialogue, is that the Abe Cabinet change its current rigid insistence on “no dispute over the islands and no room for negotiations,” and make due adjustments to allow talks for a solution to be found.

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Figure 1: Overlapping ADIZs



Source: Chinese Defense Ministry, Reuters, US Energy Information Agency **Note:** ADIZ = Air Defense Identification Zone. The darker shaded area shows where China's and Japan's ADIZs overlap. For difference in Japan's and China's ADIZ policies, see text.