

Why Chinese Sanctions on Japan Might Not Be Effective^{*}

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With the escalation of Sino-Japanese territorial disputes around the *Diaoyu*/*“Senkaku”* Islands, the Chinese voices for imposing economic sanctions on Japan to obtain political objectives have been growing louder. Although there has been no official support for economic sanctions on Japan,¹ it might be the first time that China holds a relatively open debate on the diplomatic effectiveness of economic sanctions. In spite of China’s long-standing opposition to economic sanctions, it would not be unnatural for China to consider such a leveraging of its economic clout as a new component of its diplomatic portfolio and geopolitical power. However, it is less evident, and in my view, less sensible, to believe in the efficacy of imposing economic sanctions on Japan.

A NEW OPTION IN CHINA’S DIPLOMACY WITH JAPAN: ECONOMIC SANCTIONS

Economic sanctions have long been regarded by China as a political and strategic tool of Western countries to contain or isolate China. As one of the largest economic powers in the world,

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Japan has traditionally been more cautious in imposing economic sanctions on China compared with other Western nations. However, there have been several cases in which sanctions were used, for example, the Japanese yen loan freeze after Tiananmen and the temporary suspension of aid after China's nuclear test. In 1990s, when the economic disparity between Japan and China was still considerable, sanctions were a one-way policy option of Japanese statecraft. In the 2000s, though, the disparity shrank and a diplomatic realignment occurred. On the eve of China's accession to the World Trade Organization (WTO), Japan imposed safeguards on three Chinese agricultural products. As a punishment, China initiated 100% tariffs on Japanese automobile, air conditioner and hand-phones to China. This trade conflict ended quickly after Japan decided to end the safeguard. This might be the first case of China's use of economic weapons in dealing with Japan, a case in which it succeeded. At the same time, it served more as a passive counter-measure and less as an offensive economic initiative. After the "Fishing Boat Incident" in 2010,² the Japanese media reported that China tentatively stopped its export of rare earth minerals to Japan. If the coverage was accurate, this could be seen as China's first case of utilizing economic sanctions in its diplomacy with Japan. However, there was no extensive discussion on the topic in China.

In September 2012, in the wake of the Japanese government's decision to nationalize the *Diaoyu*/*"Senkaku"* Islands, an unprecedented debate on using economic sanctions against Japan occurred in China. In the *People's Daily* (overseas version), an article contended that, the "Japanese economy lacks immunity to China's economic measures. Japan has survived the two lost decades because of the sharp increase of Sino-Japan trade and Japan's investment in China. Meanwhile, Japan is increasingly dependent on China's market. China has resoluteness of 'killing 1,000 enemies even with the cost of sacrificing 800 own soldiers' and economic resilience. Is Japan ready to have another lost decade or even two decades?"³

Another article warned that the increasingly affluent Chinese business community and public could use political preferences in choosing their investment and consumption decisions.⁴ In mid-

September, *China Newsweek* published a special issue entitled, “Sanctioning Japan: Economic and Trade Tools and Choices,” in which specific fields of economic sanctions were discussed in detail.⁵ At the time of writing, China’s official authority has yet to broach the issue of imposing economic sanctions on Japan. As a tool of geopolitical power, sanctions have been the subject of discussion in recent years by political scientists, economists and legal scholars in China and might have been discussed or debated by China’s decision makers.⁶ The geographic proximity of Japan to China and the diplomatic relations of *Zhengleng Jingre* — referencing the “hot” economic relations and the “cold” political relations between the two countries — makes Japan a more likely candidate for economic sanctions.

SINO-JAPAN ECONOMIC RELATIONS STRUCTURE DECIDES
THE EFFECTIVENESS OF ECONOMIC SANCTIONS
ON JAPAN WOULD BE LARGELY LIMITED

At first glance, arguments for imposing economic sanctions on Japan seem to be attractive, plausible and even convincing. In the extant debates, two arguments are typically made in favor of sanctioning Japan. First, China’s overall economic output has surpassed that of Japan and the Japanese economy is highly dependent on China. Therefore, Japan is highly vulnerable to economic isolation from China. Second, while China might face global consequences for imposing economic sanctions on Japan, it has more resilience to accommodate the side effects of these consequences and thus to limit the damage. Therefore, economic sanctions would result in positive net effects. The boycott of Japanese products and the sweeping cancellation of Japanese travel tours have made many Chinese and some foreigners believe in the effectiveness of future economic sanctions. But the two

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arguments for sanctions are misleading in that they are based on superficial analyses, which ignore the basic structure of Sino-Japanese economic relations and the very nature of the global economy. In what follows I critically interrogate the myths that sustain arguments for sanctions.

Myth 1: Japan Is Uniquely Dependent on Chinese Demand

The trade volume between China and Japan increased from USD1.1 billion in 1972 to USD344.9 billion in 2011. In 2011, Japanese exports to China accounted for 19.7 per cent of Japan's total exports.⁷ At first appearance, then, the Japanese economy is highly dependent on the Chinese economy and would be vulnerable to economic sanctions. Japanese products are visible in many Chinese markets, particularly in automotive goods. In China, it is often argued that Japanese auto companies are highly dependent on Chinese consumption. Indeed, one research institution hints at the particular vulnerability of Japanese auto exports.⁸ In September 2012, the leading Japanese car companies' sales in China recorded sharp declines compared with the previous month (Toyota sales were down 49%, while Mazda and Mitsubishi sales were down more than 60%).⁹ Anti-Japanese protests, including the deliberate crashing of Japanese cars in China, made some Japanese insurance companies such as Tokkio Marine and Nichido Fire stop selling coverage for riots to businesses with operations in China.¹⁰

However, we should not exaggerate China's market significance for Japan. In fact, sales shares in China for the leading Japanese car companies are surprisingly low. In the first half of 2012, the sales shares in China of the leading Japanese car companies were as follows: Toyota, 10.2%; Honda, 17.2%; Mazda, 15.9%; Nissan, 25.8%; and Mitsubishi, 5.0%.¹¹ To put it simply, the reality is that China's market is an important, but not a dominant market for Japan.

Beyond this, we must ascertain the basic structure of Sino-Japanese economic relations. For Japan, China has primarily served as a manufacturing base for exports to Western markets. Grasping this primary characteristic of the China-Japan economic relationship is vital for drawing appropriate policies. For instance,

Japan's *White Paper on International Economy and Trade 2005* includes a special section on the trilateral structure of trade between China, Japan and countries in Southeast Asia.¹² The key components are made in Japan and some parts and components are made in Southeast Asia. These intermediate goods from Japan and Southeast Asia are then shipped to China for assembly and then mainly exported to the U.S. and the European Union. The consequence is that Japanese exports to China are mainly in the form of intermediate goods rather than final consumer products. In other words, despite the huge volume of trade between China and Japan, the latter's *de facto* main export destination is *Western markets*. In terms of the composition of Japanese exports to China, the majority (or roughly 50%) of goods are electronic components and steel and chemical materials (mostly high-end intermediate goods), which are followed by industrial machines and equipment (at about 24.2%) in 2011.¹³ The final consumer goods share of trade is relatively minor in Sino-Japanese trade, with automobiles and food accounting for 4.3% and 0.2% respectively.¹⁴ In this sense, the imposition of economic sanctions on Japan might only be effective when blocking

Japanese intermediate products and industrial machines, rather than boycotting Japanese consumer products such as cars, cosmetics, cameras or food. In doing so, however, China's manufacturing sector would suffer for the reason that it is dependent on Japanese technology and intermediate parts. Indeed, Japan's strength lies with its technological advantage, which would be less vulnerable to economic

China's manufacturing sector would suffer from the sanction since it is dependent on Japanese technology and intermediate parts.

sanctions. For this reason, Japanese exports to China did not decline in the wake of the deterioration of Sino-Japanese political relations.¹⁵ In terms of Japanese auto exports, there was in fact a 67.3% decline in October 2012 compared to September 2012. However, the export of automobile parts only recorded a 13.8% decline during the same period.¹⁶

Myth 2: Economic Sanctions Would Hurt Japan More Than China

The rationale of this argument is that the Sino-Japanese trade share of China's external trade is smaller than that for Japan. During the 2000s, the share of trade with China became increasingly important for Japan's external trade, rising from 7.9% in 2001 to 19.1% in 2011. In 1996, Sino-Japanese trade was 1/3 of U.S.-Japanese trade, but in 2006 these two figures became almost identical. China surpassed the U.S. to become the largest trading partner of Japan in 2009. By way of contrast, Japan was China's 4th largest trading partner in 2011. For this reason, some argue that economic sanctions would bear more damage to Japan than to China.

This argument is misleading because it ignores the basic structure of Sino-Japanese economic relations. The division of labor between the two economies is critical in this regard. From the standpoint of Japanese capital, China offers low-cost labor for low-value-added manufacturing, the products of which are exported to Western markets. For instance, in 2009, the Apple iPhone was assembled in China (mainly by Foxconn), but the components were produced elsewhere; and of course the final product was shipped to the United States. In this production chain, Foxconn appropriated only USD6.5 per unit against a total unit cost of USD172.46.¹⁷ Although China is still attractive as a low-cost manufacturing base, this function in the global division of labor could be lost to other countries. For example, in a poll conducted by Nikkei and CSIS in early 2013, 76% of Japanese business respondents said that China's manufacturing base would be less important in the future. For these respondents, the top destinations for future investments were ASEAN countries (47.9%) and India (41.9%), with China only securing 3.6% of votes.¹⁸ This kind of investment poll is important to keep in mind. After all, the number of Japanese subsidiaries in China increased 2.5 times over the past decade, reaching 5,500 in 2011. Furthermore, while Japanese foreign direct investment (FDI) in China accounts for only 4-5% of total FDI in China, most of this investment is in the manufacturing sector, which provides many employment opportunities for Chinese

workers.¹⁹ The relocation of these enterprises would thus entail a loss of jobs and technology for China. Hence, if China's model of economic growth does not shift from an export- and foreign investment-driven model into a domestic consumption-driven model, the net effects of economic sanctions will be highly uncertain. The loss of Japanese manufacturing investment would not only affect Chinese employment, but also its command of technology and management know-how, both of which are requisites for China's future development on the chain of value added.

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Myth 3: Economic Sanctions Are a Bilateral Issue

This argument is misleading as well. First, China has been a member of the World Trade Organization (WTO) since 2001 and is subject to its rules, obligations, and punishments, including suits. Second, China is embedded in a globally connected world economy, especially in East Asian production chains. In the case of Iphone production, Foxconn Technology Group imports electronic components from Japan and Korea and assembles them in China. If China blocks economic ties with Japan, the Iphone production chain will be disrupted and Chinese companies will lose out. In 2011, Japan exported USD161.4 billion of value-added material and equipment to China, USD68.5 billion of the same products to Korea and USD50.6 billion to Taiwan. Korea exported USD134.1 billion of the same goods to China. Taiwan exported USD83.9 billion of LCDs and semi-conductors to China.²⁰ In these ways, the economies of East Asia have been integrated into a *regional manufacturing network*. If China were to break this network, producers and consumers in Japan, other Asian countries and around the world would be antagonized. For this reason, the imposition of economic sanctions on Japan would have regional, and possibly global, ramifications.

Myth 4: A Resource Blockade Could Be Effective

As a resource poor nation, Japan is more sensitive to external shocks in resource supply. However, the effectiveness of a resource blockade in global economy is questionable, as witnessed in the case of rare earth minerals. Rare earth metals are important for producing hybrid cars and sophisticated electronic products. Previously, Japan imported 90% of its rare earth minerals from China. In the aftermath of 2010 “Fishing Boat Incident,” the Japanese media reported that China tentatively suspended exports of these products to Japan. China did not officially respond to this story and it remains unknown whether China did in fact block the export of these commodities. But, judging from the data on Chinese rare earth exports, a sharp decline occurred in 2010, when China exported two tons less than it did the previous year. The loss of these critical inputs caused a panic in Japanese industrial circles. However, over the following year, Japan took three measures to reduce its dependence on China for rare earth imports. These measures included diversifying import sources, decreasing the usage of rare earth minerals through technological innovation, and recycling these products. Consequently, Japan’s demand for rare earth minerals decreased and Japan began to import rare earth from other countries such as Vietnam, Malaysia, Australia, Kazakhstan and the U.S. In the process, Japan’s dependence on China for these products decreased from around 90% to less than 50% in 2012. This sharp decline in Japanese demand created a problem of over-supply in China, as evident in the fact that China exported only 60% of its rare earth export quota in 2011. According to Chinese customs data, China’s rare earth export value in 2012 shrank by 66.1% from the previous year.²¹ It must be noted as well that Japan has developed, since the oil shocks on the 1970s, an extremely high resource-resilience, particularly in saving or reducing energy. Japan could also turn to the WTO, which would surely scrutinize any restrictions on exports. Indeed, in 2012, Japan joined the U.S. and the EU in a WTO suit related to China’s restrictions on rare earth exports. For these reasons, a unilateral resource blockade would not be as effective as proponents of one suggest.

Myth 5: Nationalism Might Promote an Extensive Boycott of Japanese Products

In some quarters, it is claimed that an extensive boycott of Japanese products will be a positive product of anti-Japanese nationalism in China. There are several reasons why this argument is incorrect. First, in the globalized world economy, there are few products that are made purely in a single nation-state. For those who wish to boycott Japanese products, difficulties will appear in determining the nature of a “Japanese” commodity. Is a Japanese camera with a lens made in Japan, a frame made in the Philippines, a strap made in Vietnam and a final assembly in China, a Japanese product or not? The majority of Japanese cars in China are made in China rather than in Japan. With these examples in mind, it is increasingly difficult to find strictly made-in-Japan products.

Second, it is more likely that consumer preferences for a better quality of life would prevail over blind nationalism. With the development of Chinese living standards, Internet use, and knowledge of international issues, the Chinese public is more likely to choose products based on quality than on nationalism. Although Japanese car and cosmetics companies experienced a decline in sales in the last four months of 2012, Japanese consumer products that are directly related to health and daily life witnessed a significant increase. For example, Unicharm’s diaper sales in 2012 increased by 20-30% over the previous year and the company decided to invest 10 billion yen to build its fifth factory in China.²² Furthermore, three major Japanese air purifiers (Panasonic, Sharp and Daikin) now occupy 40% of China’s market. But the market share of China’s leading air purifier (*Yadu*) decreased to 15% in 2012.²³ In sum, preferences for health and a better quality of life will likely prevail over blind nationalism. Even Japanese car sales have begun to recover in 2013. For example, Toyota, Honda and Nissan all registered more than a 20% sales increase in January (Toyota 23.5%; Honda 22.0%; Nissan 22.2%).²⁴

Myth 6: Fewer Chinese Visitors Might Seriously Damage Japan’s Tourism Sector

The Japanese government initiated *Kankou Rikoku* (Tourism-based Country Promotion) in the early 2000s and the Japanese

Diet passed the *Tourism-based Country Promotion Basic Act* in 2006. The Japanese cabinet has listed tourism as an important field of growth in 2012 and aims to increase foreign visitors to Japan to 1.8 million by 2016. To this end, China is considered an important market for Japanese tourism.²⁵ Already, the number of Chinese visitors to Japan was 1.043 million in 2011, accounting for 16.8% of total inbound visitors.²⁶ Furthermore, China ranked second in terms of sending tourists to Japan after Korea (1.658 million) in 2011.²⁷

However, since the Japanese government's "nationalization of the *Diaoyu*/'*Senkaku*' Islands," Chinese tourists have cancelled Japanese travel packages, resulting in a sharp decline in the number of visitors. According to statistics of Japan's National Tourism Organization, year-on-year growth (2011-2012) in the monthly number of Chinese visitors was +88.8% in August but -43.6% in November and -34.2% in December.²⁸ According to a large online poll conducted by sohu.com in October 2012, 93.6% of Chinese respondents with travel plans to Japan said that they would cancel their travels.²⁹ For advocates of a tourism boycott of Japan, the rationale is that Chinese visitors are central to the tourist industry of Japan. But this rationale is misleading: the impact of a tourism boycott would be limited.

First, tourism is not a core industry of Japan, and the Japanese tourism sector is not dependent on Chinese tourism. Traditionally, Japan is not among the major destinations of international tourists and few Japanese believe that tourism could really revitalize the Japanese economy.³⁰ Furthermore, Japan's tourism and tourism-related industries are focused primarily on the Western market rather than on the Chinese market. Japan Airlines suffered more than 10,000 ticket refund requests in October 2012, but routes to China account for only 3-4% for the JAL group's revenue.³¹ Japan's Tourism Agency Director expected that, despite the sudden turbulence in Sino-Japanese relations in late 2012, the long-term implications would be limited.³² In the Korean case, the sharp decline of Korean visitors to Japan was due more to currency and nuclear concerns than to the territorial dispute between the two countries.³³ In any case, Tokyo's hotel occupancy has recovered

to the pre-tsunami level of September 2012 and major high-end hotels have been largely immune to the shockwaves of the Sino-Japanese territorial dispute, as most guests are from Western countries.³⁴ As 76% of Chinese visitors enter Japan with tour groups, which involve low cost competition among travel agencies, the profitability of Chinese tour groups remains to be improved. In 2011, business guests accounted for only 18.7% of Chinese visitors to Japan in contrast to 33.3% of Americans, 35.7% of U.K. travelers, and 54.5% of Germans.³⁵ High-end business travelers are usually considered to be more profitable than group tourists, and Western guests are still regarded as the main source of tourist revenue in Tokyo and other major Japanese cities. For instance, in October 2012, there were 20,000 business visitors in Tokyo as part of the World Bank and IMF annual conventions.

Second, Chinese visitors to Japan are more important to local prefectures than to major cities. In recent years, the Japanese government has taken several special measures, including multi-entry visas through Okinawa, to attract Chinese tourists. This was expanded to three prefectures in northeastern Japan, where the disaster struck in 2011. These measures were aimed in part to revitalize Japan's sluggish local economy. The negative impact of the tourism boycott has thus been felt most sensitively by local *Ryokan* (Japanese-style inns) and hotels, where tourist groups from China usually stay. In this sense, the cancellation of trips has little effect on the broader Japanese economy. Indeed, Toshihiko Nagahama of Dai-Ichi Life Research Institute INC. has estimated a loss of 179,000 of Chinese visitors to Japan in 2010 and of 31.9 billion yen to Japan's domestic consumption due to the "Fishing Boat Incident."³⁶ According to the Daiwa Institute of Research projection, there might be a loss of 110 billion yen if Chinese visitors to Japan were to decrease by 50%.³⁷ However, this figure is too small to damage the Japanese economy.

Third, Japan could diversify the sources of foreign visitors to absorb the sharp loss of Chinese visitors. China's share of foreign tourists in Japan has been around 15%-20% in the recent years. This means that Chinese visitors are important but not dominant. Since September 2012, Japan began to actively attract non-Chinese

guests from Asia with the expectation of a sharp decline of Chinese guests. At a result, visitors from Southeast Asia, Korea and Taiwan increased by 40% in December 2012 in terms of year-on-year growth.³⁸ Furthermore, the average daily expenditure of a Chinese visitor in Japan remains lower than that of many Asian countries (China 6,814 yen; Korea 8,057 yen; Taiwan 10,916 yen; Hong Kong 17,762 yen; Thailand 7,192 yen; Singapore 15,456 yen).³⁹ With this in mind, Korea, Hong Kong, Taiwan and countries of ASEAN are being considered alternative sources of tourist revenue.

Fourth, the contribution of Chinese visitors to Japanese infrastructure and job creation should not be exaggerated. In China, it is common to see Taiwan used as a precedent for not visiting Japan. For instance, UBS has estimated that there would have been 2.3 million mainland visitors to Taiwan in 2008, as opposed to the 300,000 who actually traveled there. In the first half of 2012, tourism and hotel industries contributed half to the employment opportunities increase of 77,600 and manufacturing only contributed 4,400 jobs. 40 new hotels are under planning and investment in hotel would reach USD248 million.⁴⁰ However, analogy between Japan and Taiwan is misleading. Japan has basically finished its large-scale infrastructure construction. Furthermore, Japan has 40 years direct exchanges with China but Taiwan only has four years.

Zhengliang Jingwen

(COOL POLITICAL RELATIONS BUT WARM ECONOMIC TIES)

Sino-Japanese economic relations will be more affected by economic dynamics than by political ones. The relocation of Japanese factories from China to Southeast Asian countries such as Vietnam and Cambodia will be more likely because of China's increasing labor costs than by the worsening of political and social relations.⁴¹ Similarly, the volume of trade between China and Japan might shrink not because of a Chinese boycott of Japanese products but because of China's economic slowing down.⁴² Likewise, Chinese might avoid certain Japanese products for nuclear concerns but much less so for political ones. In any case, Japan is largely

resilient to any sanctions program because of the nature of global economy. By diversifying economic partners, Japan could avert the risks of dependence on China, as the cases of car sales, rare earth imports, and tourism reveal. By using the WTO and other institutions of global governance, Japan could also channel its political voice and legal options.

Moreover, the imposition of sanctions on Japan would generate a backlash from third parties and undermine China's own economic wellbeing. As the world's second and third biggest economies, economic confrontation between China and Japan would disrupt global supply chains, cause instability of financial markets, and collapse the possibilities of growth at regional and global scales.

The debate on economic sanctions should be driven by reason and evidence and not by sentiment and blind assertion. The evidence suggests that an economic punishment of Japan in the form of various boycotts is highly unlikely to be effective. Furthermore, as an important member of the current international economic system, China must weigh the moral and legal consequences of such actions and make a clear assessment of the possible costs to China's hard and soft powers. *Zhengre Jingre* (hot political relations but hot economic ones) is the ideal framework for Sino-Japanese relations, but *Zhengleng Jingleng* (cold political relations and cold economic ties) or even *Zhengdong Jingleng* (Frozen political relations and cold economic ties) will not happen. *Zhengliang Jingwen* (cool political relations but warm economic ties) might be the most likely situation in the short term.

Between China and Japan, cool political relations but warm economic ties might be the most likely situation in the short term.

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