

# IMF chief warns: China-Japan dispute threatens world economy

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The International Monetary Fund (IMF) has warned of the consequences for the global economy if tensions between China and Japan over the disputed Senkaku/Diaoyu islands in the East China Sea continue to escalate. China and Japan are the world's second and third largest economies respectively.

IMF chief Christine Lagarde declared in Washington last Wednesday that both “China and Japan are key economic drivers” for the world economy and should not be “distracted by territorial division.” Amid deepening economic turmoil, she said, “the global economy needs both Japan and China fully engaged.”

Lagarde's comments came as the Asian Development Bank (ADB) downgraded the growth forecast for developing Asia to just 6.1 percent this year, down from 6.9 percent in April. It warned that a deterioration of the European debt crisis or drastic fiscal cuts in the US would have a “disastrous spillover” to Asia. Even without a major global shock, the ADB stated, the region remained vulnerable to a sudden outflow of capital.

Lagarde is due in Tokyo this week for the annual meetings of the IMF and World Bank, which together are the world's largest single gathering of financial officials and bankers, with an estimated attendance of 20,000 people.

Several of China's largest state-owned banks announced last Tuesday that they would not attend the IMF/World Bank events or a world finance industry conference to be held in Osaka this month. An Agricultural Bank of China official told the media that the obvious reason for the collective boycott by

Chinese banks was “quite frankly ... Japan-China relations.”

Relations between the two countries deteriorated rapidly after Japanese Prime Minister Yoshihiko Noda formally purchased the Senkaku islands from their private Japanese owners last month. The Chinese government denounced the decision, and sent surveillance and fisheries vessels to the area.

Both governments are deliberately stirring up reactionary nationalism as their economies slow and social tensions heighten. The Chinese Communist Party (CCP) gave the green light for recent widespread anti-Japanese protests that involved violent attacks on Japanese citizens, calls for war and demands for a boycott of Japanese goods.

As a result, Japanese carmakers have dramatically scaled back production in China—the world's largest auto market. Toyota sales in September reportedly tumbled 40 percent from last year. The *Financial Times* reported last week that the Japanese share of the Chinese auto market had fallen from 26.6 percent in 2009 to 22.8 percent, allowing German carmakers to overtake their Japanese rivals for the first time.

Japanese shipping companies have reported unusual delays as Chinese customs authorities deliberately slow the processing of Japanese imports. Japan Airlines had to cut back flights to China following a China Tourism Bureau travel warning for Japan, and tens of thousands of cancellations. China has also suspended talks with Japan and South Korea over the formation of a free trade zone.

Ratings agency Standard & Poor's warned last Wednesday that "if the political confrontation [between China and Japan] drags on and further worsens ties between both countries, it may hurt Japan's macro economy and affect the credit quality of rated Japanese companies on a large scale."

Japan and China have one of the world's largest trading relationships, worth \$US340 billion a year. Japan is China's largest investor and China is Japan's largest trading partner. China has also become the largest financier of Japan's public debt, holding some 18 trillion yen or \$230 billion, following a massive 70 percent surge since 2010.

This economic interdependence has not, however, prevented Beijing and Tokyo dangerously escalating their dispute. Prime Minister Noda warned last month that foreign investment was vital for China's economic growth, and that, if Japanese companies halted investment, China could be hit economically.

Noda's decision to "nationalise" the Senkakus was largely symbolic, as Japan controls the islands. But the government has turned to right-wing nationalism as a means of diverting sharpening social tensions. Noda faces an election in the coming months. Opinion poll support for his government stands at just 20 percent, primarily due to its plans to double the country's sales tax and its decision to restart nuclear power plants.

The opposition Liberal Democratic Party (LDP) has taken a more bellicose stance against China, especially since the installation of former prime minister Shinzo Abe as party leader. In addition, right-wing Tokyo governor Shintaro Ishihara, who initially proposed to buy the Senkakus, is now provocatively calling for structures to be built on the islands.

China and Japan traded barbs over the island dispute at the UN General Assembly in late September. Chinese foreign minister Yang Jiechi told the UN that Japan had "stolen" the Diaoyu islands during the 1895 Sino-Chinese war. He denounced Japan's "nationalisation" of the islands as a "totally illegal and invalid" act that "grossly violated China's sovereignty." He warned that Japan's action was an

"outright denial of the outcome of the victory of the world anti-fascist war"—a reference to Japan's defeat in World War II—that posed "a grave challenge to the postwar international order."

In reply, Japan's deputy ambassador Kazuo Kodama insisted that the Senkakus were "clearly an inherent territory of Japan based on historical facts and international law." He maintained that Japan had begun surveying the islands before the 1895 war and said China and Taiwan had not started to claim the islands until the 1970s.

US Secretary of State Hillary Clinton had met with Chinese Foreign Minister Yang on September 24 and called for "cooler heads to prevail" because stability in Asia was vital for the world economy. Clinton's comments, however, were utterly cynical. The Obama administration has deliberately encouraged US ally Japan to take a more aggressive stance toward China as part of the White House's efforts to undercut Chinese influence throughout Asia. Washington declares itself "neutral" in the Senkaku/Diaoyu dispute, but in the same breath adds that it would be compelled to come to Japan's aid militarily in any conflict over the islands.

The economic interdependence of China and Japan is proving to be no brake on the escalating island controversy, which is threatening to spill over into the global economy. As in the 1930s, the global financial crisis is exacerbating geo-political tensions, and these tensions are in turn fuelling the economic turmoil, accelerating the slide toward depression and war.



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