

# Economic fallout of Japan-China island dispute widens

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At the last minute, two top Chinese officials—Central Bank Governor Zhou Xiaochuan and Finance Minister Xie Xuren—failed to show up at the International Monetary Fund (IMF) and World Bank annual meetings in Tokyo last Friday. The diplomatic snub is another sign that the dispute between China and Japan over the Diaoyu/Senkaku islands is exacerbating the global economic turmoil.

Expressing the fears held in international financial circles, IMF chief Christine Lagarde warned: “We hope that differences, however long-standing, can be resolved harmoniously and expeditiously so that, from an economic point of view, cooperation can continue.”

The global implications of the dispute between China and Japan are underscored by the fact they are the world’s second and third largest economies, respectively. The two countries account for nearly one fifth of global gross domestic product (GDP) and their two-way trade amounts to over \$US340 billion a year.

The two most senior Chinese financial officials pulled out ostensibly for “scheduling problems” and sent their deputies instead. China’s “Big Four” state-owned banks also collectively boycotted the meetings. The moves were clearly aimed at humiliating the Japanese government, which hosted the events.

Relations deteriorated after Japanese Prime Minister Yoshihiko Noda formally purchased the Senkaku islands, which were already under the control of the coastguard, from their private Japanese owners in September. The decision was aimed at stirring up Japanese nationalism as a means of diverting mounting domestic discontent over Noda’s unpopular policies,

especially the doubling of the country’s sales tax and the restarting of nuclear power plants, which were shut down after the Fukushima nuclear disaster in 2011.

Noda told *Businessweek* after China downgraded its delegation: “These are the second and third largest economies in the world and our interdependence is deepening. If our ties cool, particularly economic ones, then it isn’t question of one or the other country suffering. Both countries lose out.” He urged talks over the Senkakus, in order “to make sure there is no effect on the broader relationship.”

Beijing, however, believes that Tokyo has more to lose. According to an editorial in the *People’s Daily* last month, although economic conflict would be a “double-edged sword,” hurting China as well, “if Japan continues its provocations China will inevitably take on the fight.” Given that China’s expanding market was a crucial factor in overcoming Japan’s slump in the 1990s and 2000s, the newspaper warned: “Would Japan rather lose another 10 years and even be ready to fall back 20 years?”

Like Noda, the Chinese Communist Party (CCP) regime is stoking nationalism over the island dispute to divert social tensions, being produced in China by the country’s faltering economic growth. Beijing gave the green light to anti-Japanese protests last month, which led to widespread physical assaults on Japanese businesses and citizens. Under the reactionary slogan of “boycotting Japanese goods,” millions of largely middle class consumers have joined campaigns against buying Japanese-made cars or taking holidays in Japan. Chinese customs officials are deliberately delaying Japanese imports.

As a result, a JPMorgan Chase report released last week estimated that the dispute with China was likely to cause Japan's GDP to shrink by 0.8 percent in the fourth quarter—down from zero growth in the previous forecast. It predicted that Japan would not recover until at least the second quarter of 2013.

China accounts for 19.7 percent of Japanese exports, compared to 15.3 percent for the US. JPMorgan Chase projected that Japanese car exports to China would crash by 70 percent in the final quarter of 2012, with auto parts and other goods, like electronics, down by 40 percent. Chinese tourist numbers to Japan could fall by 70 percent, while Japanese tourists to China could decrease 30 percent. The report's author, Masaaki Kanno, likened the economic impact to the 2011 earthquake and tsunami. "It's like last year's disaster all over again," he said.

The concerns of the Japanese corporate elite were spelled out by Junko Nishioka, chief economist at RBS Securities Japan Ltd. and a former Japanese central bank official. He told *Businessweek*: "This is the last thing Japan needs right now, given the overseas slowdown and the sluggish economy. The dispute [with China] has become much more serious than we initially expected."

While Noda is calling for talks over the Senkakus, some factions of the ruling Democratic Party of Japan (DPJ) are insisting on a hard-line response. Economics Minister Seiji Maehara, who as foreign minister took a tough stance against China in the last diplomatic row over the Senkakus in 2010, told the *Financial Times* last Thursday: "I cannot sympathise with comments that put the priority on economic issues because our sovereignty is the basis of the nation on which economic activities are dependent."

Maehara suggested that the Chinese economy would be hit hard as well. "Our economic interdependence is very strong [and] if Japanese products made in China do not sell in China, it will have a huge impact on employment there."

Maehara and other hawkish figures are encouraged by

the Obama administration, which regards a more assertive Japan as a boost to its efforts throughout Asia to undermine China's influence. While officially claiming to be neutral in the island dispute, Obama officials have repeatedly said the US would be obliged to militarily back its ally, Japan, in any conflict over the Senkakus.

In late 2010, the US encouraged Japan to modify its "defence guidelines" to reorient its military posture from the traditional Cold War focus against Russia in the north, to the "southwest island chains," including the Senkakus, and to designate China as the main threat.

The Obama administration bears chief responsibility for the potentially explosive economic and social consequences produced by the territorial dispute between Japan and China in the East China Sea. Its reckless policy, which is aimed at overcoming the US economic decline by using its military might to reassert American global dominance, is accelerating the slide into global depression and war.



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