

HOT ECONOMICS, COLD POLITICS: THE INFLUENCE OF ANTI-JAPANESE PROTESTS
ON JAPANESE FOREIGN DIRECT INVESTMENT IN CHINA

By

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ABSTRACT

The Japan-China relationship is one of the most significant bilateral economic relationships in the world. However, it is also convoluted by political and historical tensions, which can be characterized as “hot economics, cold politics”. Although Japan is the second largest investor in China after Hong Kong, anti-Japanese protests periodically occur in China and anti-Japanese sentiments in China are commonplace in Japanese daily news. The central conflicts between these nations are the result of the legacy of World War II and territorial disputes. While the atrocities of the past remain part of the Sino-Japanese history, this historical brutality continues to influence China and Japan relations through Chinese nationalism and anti-Japanese protests. Despite the underlying political tension, China and Japan have continued to trade and have a strong economic relationship. Japan has a powerful economy and China is the largest growing market in the world, and so Japan invests heavily in Chinese businesses. Because of this, Japanese foreign direct investment (FDI) plays an important role in both countries’ economies. FDI data over the past decade suggests that macroeconomic trends and natural disasters had the greatest effect on Japanese FDI. International FDI broadly declined in 2006, was mixed following the 2008 financial crisis, and broadly increased following the recovery from the crisis. Japanese FDI in China was an exception to the broad international increase in FDI in 2013. It is likely that the larger magnitude, longer duration anti-Japanese protests that occurred in 2012 over contentious contemporary and historical issues contributed to greater decreases in the amount of Japanese outward FDI in China. Although investment decisions are complex and take into account many factors, the decision to dramatically contract Japanese FDI to China in late 2012 and early 2013 appears to be a direct economic response to the 2012 political protests.

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Chapter 1: Introduction

The Japan-China relationship is one of the most significant bilateral economic relationships in the world. The past 20 years have witnessed a dramatic rise in intra-Asian trade; 50.1 percent of Asian exports were conducted within the region in 2008 (WTO 2009), with many products traveling from other parts of Asia to China for assembly and subsequent export to European or American markets. Moreover, China surpassed the United States to become Japan's largest trading partner in 2005, having held the second place position since 1993. Similarly, Japan is currently China's second largest trading partner after the U.S., having held the top position from 1994 to 2003. In terms of official development assistance, Japan offered China more than ¥3,063.3 billion in loans from 1979 to 2006, which accounted for more than half of the official aid that China had received at that time (Wan 2006). In addition, Japan's foreign direct investment (FDI) to China grew from \$177 million in 1987 to \$9.1 billion in 2013 (JETRO, 2013). Consequently, Japan became the second largest investor in China after Hong Kong. FDI is international capital flows in which a firm in one country creates or expands a subsidiary in another. It involves not only the transfer of resources but also the acquisition of control (Krugman & Obstfeld, 2000). In 2008 Japan's outward FDI rose to its highest level, \$ 115 billion, since 1990. The number of Japanese overseas affiliates approached 17,000 in 2007 and half of Japanese overseas affiliates in Asia are located in China. Thus, the worldwide phenomenon of globalization cannot be explained without describing the characteristics of Japan's FDI (Noh & Mah, 2011).

Despite the increasing economic integration, the political relationship between the two countries has been adversarial. The central conflicts between these nations are the result of the legacy of World War II, territorial disputes, coverage of World War II in Japanese history

textbooks, denials of Nanjing Massacre, and visits to the Yasukuni Shrine by Japanese politicians. The Nanking Massacre was committed by Japanese troops against the civilian residents of Nanking during a six-week period of the Second Sino-Japanese War starting from December 13, 1937. Although estimates vary, Chinese officials claim that over 300,000 Chinese were killed during this period by the Imperial Japanese Army (Chang, 2012). The Yasukuni Shrine is a Japanese Shinto shrine. It enshrines to war dead, including Class A war criminals, who served the Emperor of Japan during wars from 1867–1951. The Yasukuni Shrine and the Japanese Government have been criticized by neighboring countries including China as being revisionist and unapologetic about the events of World War II (Chang, 2012).

While these atrocities remain part of the Sino-Japanese history, this historical brutality continues to influence China and Japan relations through Chinese nationalism and anti-Japanese protests. The specific nature of nationalism in China is a result of unresolved historical matters as well as Chinese domestic politics and media. As a result, mutual distrust still exists between the two nations. Also, Japanese news outlets often air stories about anti-Japanese sentiment in China and this constant low-grade presence in the media of anti-Japanese feeling in China prevents the Japanese people from feeling close to China. For the past few decades, major anti-Japanese protests have occurred periodically in China. According to Jessica Chen Weiss (2008), the definition of an anti-Japanese protest is “a public manifestation by a group of people of disapproval or dissent, containing hostile feeling towards a foreign government or people, and rooted in advocacy or support for the nation’s interests, especially to the exclusion or detriment of other nations” (p.6-7). The most recent anti-Japanese protests of note occurred in 2005, 2010 and 2012.

The main impetus for the 2005 protest was the reauthorization of a Japanese history textbook by the Japanese government that, according to critics, whitewashed Japanese war crimes of World War II. The most egregious alterations involved deleting references to the killing of civilians in the infamous Nanjing Massacre of 1937 and Japan's denial of responsibility for its wartime aggression in China. Additional justifications for the protests included Japanese Prime Minister Junichiro Koizumi's refusal to stop visiting the Yasukuni Shrine in Tokyo that honors Japanese war dead, including fourteen war criminals, and objections to the negotiations for Japan to gain a permanent seat on the U.N. Security Council. On April 9, the Japanese Embassy in Beijing was surrounded by an estimated 20,000 Chinese protestors who threw rocks and shouted anti-Japanese slogans. Thousands more expressed their anger in other parts of the capital and damaged some Japanese retail stores and restaurants. The protest continued for about 3 weeks and ended in late April. In 2010, the catalyst for the protests was a maritime collision of a Chinese trawler and Japanese Coast Guard's patrol boat near the Senkaku/ Diaoyu islands. Depending on the source, the number of participants ranged from several thousand to several tens of thousands. However, there is no denying that the protests were significant. In 2012, the central motivation for the protest was condemnation of Japan's decision to purchase three of the Senkaku/ Diaoyu islands in the East China Sea. The Senkaku Islands, also known in Chinese as the Diaoyu Islands and called the Diaoyutai Islands by Taiwan, are a group of disputed islands in the East China Sea. According to Jessica Chen Weiss (2014), anti-Japanese protests happened in 208 of China's 287 prefectural cities.

The China-Japan economic relationship is convoluted by political and historical tensions and the relationship between these two nations has been dubbed "hot economics, cold politics" by scholars. How do these protests affect the economic relations of these two nations? The

conundrum is that economic relations are undoubtedly important to both nations, yet protests still continue. This raises the question; do anti-Japanese protests in China influence Japanese FDI in China?

Two international relations theories provide explanations and assumptions regarding the relationship between politics and economics. The first theory is neo-realist theory, the idea of “Politics over Economics”, which means that politics are more important than economics, therefore governments prioritize politics over economics and do not make political decisions primarily on economic concerns. Therefore, neo-realists support the idea that states will do whatever they feel necessary to protect their political interests and survival. According to Yinuo Geng (2011), “a realist perspective views power and security as the ambition of states; hence, given the central role of China and Japan, their strategic balances affect the geopolitical realities of Asia and the international system” (p. 20). Under this theory, the independent variable is politics and the dependent variable is economics. It was Kenneth Waltz who originally postulated this theory in his book, “Theory of International Politics” in 1979. The theory suggests that anti-Japanese protests do influence Japanese FDI in China and that economic interdependence on each other will not have a major influence on foreign policy decisions.

In contrast, the other theory is neo-liberal theory, which supports the idea of “Economics over Politics”, meaning economics are more important than politics and governments prioritize economics over politics and make political decision based on economical benefit. According to Gen (2011), “liberalism, with a focus on economic cooperation, seeks to describe and evaluate the increasing trade dependency between the two states” (p. 20). Under this theory, the independent variable is economics and the dependent variable is politics. The scholars who originally developed this theory were Robert O. Keohane and Joseph S. Nye in their book,

“Power and interdependence” in 1973. This theory suggests that anti-Japanese protests do not influence Japanese FDI in China. Furthermore, the theory suggests that foreign relations are connected through interdependence and that economic interdependence creates vested interests opposed to conflict. Interdependence refers to situations characterized by reciprocal effects among countries or among actors in different countries (Keohane & Nye Jr, 1973). Economic interdependence reduces conflict, i.e. “trade brings peace”, so interdependence is a form of mutual dependence.

Although the original establishment of both neo-realist and neo-liberal theory goes back to the 1970s, these two theories are the most influential approaches and well-discussed theories in the field of international relations. According to Robert Powell (1994), the debate between these two approaches still dominates much of international relations theory (p. 1).

The purpose of this thesis is to investigate the relationship between anti-Japanese protests in China and Japanese FDI in China as well as to thoroughly examine how Chinese nationalistic sentiment influenced contemporary anti-Japanese protests in 2005, 2010 and 2012 in terms of events and sources. This paper considers investment flow and anti-Japanese protest data to determine the correlation among variables. There is extensive research independently examining anti-Japanese protests in China and outward Japanese FDI in China. Also, the relationship between politics and economies in general, but not specifically on China and Japan, has been thoroughly investigated in other research. However, research that has aimed to evaluate both variables has been limited.

This topic is important because a healthy bilateral relationship between China and Japan is mutually beneficial to the citizens of both nations and contributes to the peace and stability of East Asia. This research will attempt to answer whether both economies are robust enough and

whether the bilateral relationship between the two is stable enough to be immunized from influence by protests in China. If the result of this research shows that negative political events influence the amount of FDI, it is problematic for both countries. In the current global economy, it is important that both countries seek economic collaboration, resulting in economic growth. If the amount of FDI is reduced because of negative political events due to the legacy of World War II and the way Japan has been dealing with the issue with its neighboring countries, it is detrimental for both China and Japan. If that is the case, both countries should attempt a reconciliation of their differences regarding events that happened more than 70 years ago. China's rapid economic development for the past several decades can be attributed to FDI from other countries and trade that is associated with that. Knowing with certainty that a negative political atmosphere is harming their economic relationship could push China and Japan toward improving their political relationship and this might lead to improved prosperity.

My findings show that there is a threshold for anti-Japanese protests to influence the amount of FDI and the magnitude of influence is proportional to the size of the protests. In 2012, when protests were longer and occurred in larger numbers of cities compared to the ones in 2005 and 2010, the amount of FDI in the next fiscal year decreased. This suggests that the decision making process of whether to invest in China or not depends partially on the state of Sino-Japanese bilateral relations and that political tensions are indeed important for the future of economic linkages in Asia. On the occasion of the April 2005 anti-Japanese protests, which were caused mainly by China's opposition to Japan to becoming a member of U.N. Security Council, and the summer of 2012 anti-Japanese protests, which was consisted of condemning Japan's decision to purchase three of the Senkaku/ Diaoyu islands in the East China Sea, it seems that politics influenced economics. However, in the case of the September 2010 anti-Japanese

protests, which were caused mainly by a maritime collision of Chinese trawler and Japanese Coast Guard's patrol boat near the Senkaku/ Diaoyu islands, I found no effect.

While this paper discusses the implications for how negative political events affecting economical relationship between China and Japan, it is important to point out that this study does not provide a comprehensive answer to the question. Other than political instability shown as anti-Japanese protests, there are many determinants of Japanese FDI in China such as market size, cost of capital, wages and exchange rates, etc. If a clear difference in FDI amount is observed after protest events, then it is plausible to assume that these negative events influence the amount of FDI.

This thesis proceeds as follows: In Chapter 2, as a literature review, I first note some scholarly works on contextual concepts, such as the history of tension between China and Japan, Chinese nationalism and Japanese FDI in China. Then I describe the literature on theoretical impact on FDI. In Chapter 3, I present the research design of this thesis and explain the method of researching the issue by specifying independent and dependent variables, describing the data I use and analysis procedure. Chapter 4 describes the data of each protests and Japanese FDI, and thereafter analyzes theoretical assumptions. Also, several cases are examined to strengthen my argument. The thesis concludes with discussion in Chapter 5.

Chapter 2: Literature Review

2.1 Contextual Concepts

Historical Origins of the tension between China and Japan

China and Japan have had a complex relationship spanning more than a thousand years. Japan imported Chinese characters along with other advanced skills as early as 60 AD and China was often the source of new technologies and ideas for Japan (Fisman, Hamao, & Wang, 2014). However, relations have often been characterized by hostilities. There are two especially controversial issues between Japan and China at the moment; Japan's response to the atrocities committed by the Imperial Japanese Army in World War II and the disputes over the Senkaku/Diaoyu islands (Fisman et al., 2014).

Many Chinese feel negatively about Japan because of its actions during the military occupation of China during World War II and also because of how Japan has dealt with these issues and Japan's current actions since the war's end (Geng, 2011). A survey conducted in 2004 by the Chinese Academy of Social Sciences indicated that there are only 0.7 percent who felt unneighbourly toward Japan because of personal unhappy experiences or those of family members. Each country has its own interpretation of the war between China and Japan and this could be one of the biggest sources of tension between the two nations. One of the most controversial issues is the number of civilians and soldiers that were killed in Nanjing, China in 1937. The Nanking Massacre Museum in Nanjing states that 300,000 people were slaughtered. However, the Tokyo Trial claimed that the Japanese army killed 200,000 Chinese civilians and

POWs; and some in Japan believe the number to be only 50,000 (Yoshida, 2006). Contemporary Chinese people may feel that Japan does not acknowledge the extent of the massacre.

Yinuo Gen interviewed Chinese youth about these historical tensions and he asked what could be done to ameliorate Sino-Japan relations. He found that all those interviewed believed that the Japanese government should apologize sincerely and support the apology with deliberate actions. According to Gen (2011), "...the interviewees are aware of apologetic statements made by various Japanese administrations, but the problem occurs in the wording of these statements and the impression that Japanese actions (such as visits to Yasukuni Shrine, media attention on radical right-wing commentators, revision of school textbooks, and election of rightist politicians) undermine the value of those words" (p 14). For example, at the 58th Memorial Ceremony for the War Dead, former Prime Minister Junichiro Koizumi stated "...during the war, Japan caused tremendous damage and suffering to the people of many countries, particularly to those of Asian nations. On behalf of the people of Japan, I hereby renew my feelings of profound remorse as I express my sincere mourning to the victims" (Koizumi, 2003). Even though the Japanese government issued an official apology as evidenced by the speech, the speaker himself, former Prime Minister Junichiro Koizumi, still visits Yasukuni Shrine to honor the Japanese war dead who committed the atrocities. Visits to Yasukuni Shrine by Japanese politicians are seen as tacit support of the soldiers of the Japanese Imperial Army and their actions. The Chinese people have interpreted this support as insincerity. In addition, revisions of history textbooks used in middle school and high school can be interpreted as attempts by the Japanese government to conceal facts about World War II from subsequent generations.

Chinese youth also expressed discontent that individual victims were poorly compensated or not compensated at all. When discussing the apology issue, the Chinese youths ultimately

compare Japan's lack of appropriate remorse to Germany's clear actions. Even now, German companies have provided billions of dollars to their wartime victims and Holocaust survivors are still receiving regular compensation (Chu, 2007). According to Geng (2011), "Chinese youths are very aware of the difference in post-war actions between these two Axis powers and there is a sense of relative deprivation with regards to justice. After all, denials of the Holocaust are outlawed in Germany" (p 15). From the Chinese perspective, Japan has not made a sincere admission of guilt or paid war reparations. In the absence of a genuine apology from Japan, such as the one Germany provided to Holocaust victims, tensions between China and Japan are unlikely to ease.

Another major issue between Japan and China is the dispute over ownership of the Senkaku islands. These islands, also known in Chinese as the Diaoyu Islands, are unpopulated rocky outcroppings located between Taiwan and the Ryukyu Islands. These islands have long been a point of dispute between Beijing and Tokyo, especially after the early 1970s when experts estimated that large oil deposits might be located on the continental shelf (Whiting, 1989). When Okinawa was returned to Japanese control from the United States under the Okinawa Reversion Treaty in 1971, the Senkaku islands also were returned to Japan (Lee, 2002). According to Shirk (2009), a Zhejiang University professor said "Japan's ambition of seizing oil and gas resources on the continental shelf of the East China Sea is a new form of its expansionist and invading ideology during World War II" (p. 147).

There are three national foreign policy relationships that China's leaders consider the most "sensitive" in domestic politics; those with Japan, Taiwan, and the United States. Of these three countries, Japan is the most critical zone in all aspects of China's foreign relations due to domestic sentiment about the aforementioned issues. For these reasons, Sino-Japanese relations

require a skillful balancing act on the part of Chinese leaders (Zheng, 1999). Moreover, the issue involving Japan is an emotional one and Shirk (2009) stated "...it is the one issue on which public opinion really matters to the government" (p. 144).

Chinese nationalism

A discussion of the impact of anti-Japanese protests on Japanese FDI in China would be incomplete without a thorough examination of the distinctive nature of Chinese nationalism, as it can play a major role in motivating Chinese people to protest. Chinese nationalism has its roots in social movements of the early 1900s after the fall of the Qing dynasty and current nationalism in China is not a continuation of the earlier type. It was only when China engaged in international relations that the feeling of nationalism emerged. Guoguang Wu (2008) categorizes the first episode of Chinese nationalism as the post-imperial May Fourth nationalism and he described the latter as "the resurgence of nationalism rooted in a framework to examine nationalism's connections with material interests, political power and cultural orientation" (p. 467). Opinions vary on the type and form of nationalism. With respect to the type of nationalism, Allen Whiting (1995) suggested that there are three types of nationalism: affirmative, assertive and aggressive. Affirmative nationalism has a purely positive dynamic because it focuses exclusively on "us" as an in-group that takes pride in its national attributes and achievements. According to Jing-Dong Yuan (2008), this type of nationalism originates from feelings of patriotism and love of country. Assertive nationalism adds "them" as a negative out-group referent that challenges the in-group's interests and possibly its identity. Aggressive nationalism identifies a specific foreign enemy as a serious threat that requires action to defend vital interests (Whiting, 1995). Yuan (2008) stated that this type originates from the sentiment of historical

indignation and victimization by Western countries and Japan. Alastair Johnston (1996) describes Chinese identity realism as the regime's efforts to intensify in-group cohesiveness and the potential dangers posed by out-groups.

According to Suisheng Zhao (2005), there are two forms of nationalism: ethnic nationalism and liberal nationalism. He defined that ethnic nationalism "produces a state-seeking movement to create an ethnic nation-state"(p. 133). Today, only among Tibetans, Uighurs, and Mongols has ethnic nationalism remained alive. Liberal nationalism was introduced in the early twentieth century as a means to improve China through political and social reforms. Although liberal nationalists have identified with the Chinese state in the battle against foreign imperialism, they have not necessarily supported the Communist party, pressing for greater public participation in the political process and challenging authoritarian rule. Today's Chinese leaders must compete with both ethnic and liberal nationalism to offer their own nationalist vision to build a nation-state and assure that nationalism is a force over which the party maintains control. As a result, pragmatic nationalism began to occur. Zhao (2005) uses the term "pragmatic nationalism" in the same way as "state-led nationalism", meaning that the CCP uses nationalism as an effective instrument for enhancing the CCP's legitimacy.

The cause of nationalism in China can be classified as either historical or CCP controlled. Some scholars suggest there are deep historical reasons for Chinese people to be nationalistic, which motivate protests. However, there are others who suggest the CCP uses nationalism and anti-Japanese sentiment to legitimize the CCP in the face of social and economic change. Nationalism rooted in history can be considered "bottom-up nationalism" and the one controlled by CCP as "top-down nationalism".

Peter Hays Gries (2004) supports the idea of “bottom-up nationalism” and argues that nationalism in China is in fact a mass movement and not controlled by CCP. He states that the history of humiliation by Western countries and Japan and the passions of the masses contribute greatly to nationalism in China. These passions, which are affected by emotion, are important for understanding nationalism in China. The Chinese consider that they are superior to the Japanese and the Japanese do not acknowledge this supposed Chinese superiority. In this situation, the Chinese would accept any apology by the Japanese government. Especially in the case with Japan, there is not only the anger stemming from Japanese war atrocities during World War II, but also a higher ethical anger based on the perceived injustice of Japan’s humiliating defeat of China of during the Sino-Japanese War of 1894 to 1895. Therefore, Gries’ argument is that angry emotions, which are rooted in history, are the cause of nationalism in China.

On the other hand, there are some scholars who support the idea of “top-down nationalism” and argue that the CCP uses nationalism and anti-Japanese sentiments to legitimize the CCP in the face of social and economic change and the declining appeal of communism. In theory, all the information received in China, through media and education, is controlled by a single party system. After the collapse of communism, the CCP needed a cause to unite the Chinese people and as the CCP found, promoting nationalism was the best way to do so. Joseph S. Nye (1993) found that “nationalism proved to be stronger than socialism when it came to bonding working classes together” (p. 61). Suisheng Zhao (2005) explained that nationalism has become an effective instrument for enhancing the CCP’s legitimacy and pragmatic nationalism identifies China closely with the Communist party. Chinese politicians use Japan-related issues to mobilize support for themselves as strong leaders or to divert attention from

difficult domestic problems. The less confident the leaders, the more they fan the fires of anti-Japanese nationalism (Shirk, 2009).

The key component of this argument is the Patriotic Education Campaign, the first official document which was issued by the CCP Central Propaganda Department in 1991, 2 years after the Tiananmen Incident. Zhao (1998) mentioned "...the essence of the patriotic education campaign was to make the Chinese people support the leadership of the Communist Party" (p. 296). Also, he argued that the patriotic education campaign in Post-Tiananmen China influenced the rise of nationalism and he calls this movement "state-led nationalism". He concluded that "...a vigorous official propaganda campaign in patriotic education was behind the seemingly spontaneous rise of Chinese nationalism in 1990s" (1998, p. 300).

Regardless of whether Chinese nationalism is rooted in history or the CCP, there is no denying that the method of history instruction in China plays a major role in instilling nationalism in Chinese people. For example, the memory of Imperial China is distorted and based on these distorted memories, the Chinese blame all diplomatic controversies on western nations for their imperialist exploitation and especially neighboring countries for their ungratefulness to the Chinese empire (Yu, 2014). Due to the declining appeal of communism, as well as the corruption and isolation of official academia, the Chinese government is under heavy pressure to follow the distorted memory and restore China's historical glory (Yu, 2014). According to Nozaki and Inokuchi (2000), the content of a history textbook is important and can form the basis for a national identity. Unlike subjects such as mathematics and science, history is subjective and context is necessary to put events, people, and ideas in perspective. They argue that education is one of the most effective ways to promote a national narrative, namely official

history, and to make and remake certain individual identities into national identities through selection bias.

In sum, the salient point when understanding nationalism in China is that there is no one single definition to describe all the nationalistic sentiment in China. Instead, it is a combination of those elements mentioned above. This is especially true in the years following China's admittance to the WTO in 2001 and its rapid economic growth. The environment surrounding Chinese citizens has been changing very rapidly as well, which has resulted in changes in the types of nationalism. It seems that new a generation of nationalism is a mix of what is rational and realistic. For example, according to the data published by Ipsos-Reid in 2004, many Chinese people have a positive image toward American corporations. According to the data by UNESCO in 2006, the country that accepts the most Chinese exchange students is the US, with the second most being Japan. This is counterintuitive considering that most of the recent major anti-foreign protests in China are against either the US or Japan. Despite the dissimilarities mentioned above, some similarities in Chinese nationalism can be found in published literature. One is that if it were not for nationalistic sentiment, Chinese people would not have anti-Japanese protests. The other is the fact that nationalism can be regarded as a double-edged sword in the authoritarian context. Regardless of the cause of Chinese nationalism, whether it is historical reasons or in the interest of the CCP, it could backfire on the ruling CCP. The CCP needs their own citizens to be supportive of their regime. However, if they become too nationalistic, they may harm the CCP. Students demonstrations are an important political phenomena in many countries, but they carry special import in China because of their historical role in challenging authority (Whiting, 1989). Whenever anti-Japanese emotions boil over into large-scale protests, it takes a delicate touch to halt the protests without having them turn against the CCP instead. As a scholar Zhen Yongnian

(Zheng, 1999)says, the use of nationalism is beneficial for the regime, however it must stop at some point. In South Korea during the 1960s, public protests against what people viewed as the weak stance of the country's dictatorial leaders in dealing with Japan fueled the movement toward democracy – the same thing could happen in China (Shirk, 2009).

Japanese FDI in China

Despite the underlying political tension, China and Japan have continued to trade and have a strong economic relationship. Japan has a powerful economy and China is the largest growing market in the world, and so Japan invests heavily in Chinese business. Because of this, Japanese FDI plays an important role in both countries' economy.

The definition of FDI is international capital flows in which a firm in one country creates or expands a subsidiary in another. It involves not only the transfer of resources but also the acquisition of control (Krugman & Obstfeld, 2000). Sodersten and Reed (1990) further articulate that FDI is in essence a collection of capital, technology and management skills transmitted by multinational enterprises or transnational corporations. According to John F. Cassidy (2002), FDI is cross-border expenditures to acquire or expand control of productive assets, and the asset may be wholly-owned or part of a joint venture relationship.

Strategically, forms of FDI can be divided into two types, namely, vertical FDI and horizontal FDI. The main purpose of vertical FDI includes securing natural resources, such as timber, pulp, and paper products, as well as gaining entry into markets, such as food and chemical products. With vertical FDI, different stages of activities are added abroad. There are two sub-types of vertical FDI. One is called forward vertical FDI and is where the FDI takes the corporation nearer to the market. Toyota acquiring a car distributorship in America is an example.

The other one is called backward Vertical FDI and is where international integration moves back towards raw materials. Toyota acquiring a rubber plantation is an example. This type of investment, which may be called “complementary” or “pro trade” pattern, does not impact domestic production and employment negatively at home. On the other hand, horizontal direct investment may either reduce, or conversely increase, both domestic production and employment (Kishi, 2003). With horizontal direct investment, companies carry out the same activities abroad as at home. An example is that Toyota assembles cars in both Japan and the United Kingdom.

The increase of Japanese FDI has been remarkably high since the mid-1980s, and in 1989 Japan was the world's largest FDI supplier in terms of the value of annual flows (Urata, 1993). When compared to other leading investing countries, Japan was the notable exception as most of the other leading investing countries, such as the United States, the United Kingdom and Germany, are also major recipient countries of FDI. FDI influences the economic and trade performance of the investing as well as the recipient countries. By creating employment, by transferring foreign technology, and possibly by expanding exports, FDI promotes the economic growth of recipient countries. The effect on investing countries is more mixed. FDI may improve the allocation of resources by speeding up the process of structural adjustment, while it may deteriorate the economic situation by removing the industrial base out of the investing countries, a “hollowing out” of the industry (Urata, 1993).

Market size, cost of capital, political stability, levels of literacy, exports from foreign invested enterprises in China, township and village enterprise growth rates, wages, exchange rates, economic integration and cultural differences have been found to be determinants of FDI in China (Cassidy, 2002). The real exchange rate between the Yuan and Yen could be one of the most important variables to determine Japanese FDI in China. According to Xing (2006), while

FDI has many determinants, these empirical results suggest that the real exchange rate is one of the significant factors affecting Japanese FDI in China, and the fluctuations in Japanese direct investment in China over the period can be attributed to the fluctuations of the real bilateral exchange rate.

The key point is that unlike total trade (imports and exports), FDI is driven by one side investing in the other. In the Japan and China case, it is the decision of Japanese businesses to invest in China. Is the decision mostly economic or can Chinese domestic political and social conditions influence these investment decisions?

2.2 Theoretical Impact of Politics on Economics

Neo-realist theorists argue that politics are more important than economics. Therefore governments prioritize politics over economics and do not make political decision based on economic benefit. Therefore, neo-realists support the idea that states will do whatever they feel necessary to protect their political interests and survival. Pollins (1989b) used the Conflict and Peace Data Bank (COPDAB), coded diplomatic events reported in newspapers. He has modified it to weight events according to significance and proposed that importers trade with friendly counties in order to manage risk and minimize potential economic disruption. Therefore politics does influence economy and political factors that influence the likelihood of future conflict affect economic relations. Also, in his other article, he stated that “In addition to considerations of price and quality, consumers may wish to express goodwill or solidarity toward those whom they identify as friends, while shunning or punishing those they perceive as foes” (Pollins, 1989a, p. 740). Analysis of trade and conflict by Keshk, Pollins, and Reuveny (2004) concluded “Political relations are driving commerce, not the other way around” (p 1175). In addition, Fisman, Hamao

and WangFisman et al. (2014) studied the impact of nationalism and interstate frictions on economic relations. They analyzed how politically hostile events, anti-Japanese protests in 2005 and 2010, reacted to the stock market and identified the economic impact on individual firms.

On the other hand, neo-liberal theorists, however, argue that politics does not have a significant influence on countries with high levels of economic interdependence. This theory is embedded in the concept of economic interdependence and scholars of interdependence rhetoric argue that “conflicts of interest are reduced by interdependence, and that cooperation alone holds the answer to world problems” (Keohane & Nye Jr, 1973, p. 7). They support the idea that due to economic interdependence, politics does not influence economic relations among nations. Davis and Meunier (2011) examined diplomatic events from 1990 to 2004 by using the King-Lowe data. The datasets provided by King and Low (2003) extends the approach of these earlier surveys, such as COPDAB, using computer coding of media reports. Virtual Research Associates Reader, a computer coding program, scans daily Reuters news reports and prepares a list of events, identifying the principal actors and major participants, the date, and the type of event according to trigger words (i.e., complaint, demonstration, size, etc.). The program is believed to be as accurate as human coders. Davis and Meunier concluded that politics do not influence economy and found no observable evidence that political tensions harmed economic relations. Finally, Maoz (2009) conducted a thorough series of statistical tests and found strong support for the paradigm that economic interdependence reduces conflict. In other words, he concluded that economics prevails over politics.

One possible reason for the incongruence between the scholars who support neo-realist theory and those who endorse neo-liberal theory could be the selection of the economic variables. When scholars investigate political impacts on economics, the results could differ based on

which economic variables they are looking at, for example, trade amount such as import and export, stock market values or the amount of FDI. The other reason could be the time scholars examined. For example, Pollins used in his original research began in 1955 and ended in 1978 and Davis and Meunier's data was from 1990 to 2004. As the environment that surrounds politics and economics has been changing dramatically for the past few decades, and as liberalization has broadened across a wide range of countries, it has become increasingly uncommon for nations to indulge in detrimental economic policies, such as trade interference, in response to political conflict.

2.3 Goals for Thesis

This study aims to contribute to the existing body of literature on this topic in three ways. The first is to present contemporary data by reviewing data until 2013. The Sino-Japanese case which Davis and Meunier examined was from 1990 to 2004 (Davis & Meunier, 2011). Fisman, Hamao and Wang examined until 2010 (Fisman et al., 2014). My study includes the 2012 anti-Japanese protests in China to see the impacts of the events on FDI in 2013.

The second goal is to evaluate the specific variables that are unique to China and Japan, that is historical tension between the two nations and nationalistic sentiment in China. This research is not for arguing whether politics influence economics in general, nor is it to compare the cases with other countries' situation. My purpose is to determine whether politics influences economics between these specific countries. Pollins (1989b) selected six different nations (the United States, the Federal Republic of Germany, the German Democratic Republic, the Soviet Union, Egypt, and India) with three worlds of development; the worlds of advanced industrial nations, socialist central planning, and developing nations to see if the model applies only to

certain types or to all. Just because politics influenced economics in those countries, it does not mean the same theory applies to China and Japan's situation.

The last goal is to use the amount of Japanese outward FDI in China to study the economic effects of politics. There are some studies which found that political variables such as multilateral summit outcomes (Bechtel & Schneider, 2010), periods of transition (Bittlingmayer, 1998), platforms of presidential candidates (Jensen & Schmith, 2005), and political connections (Fisman, 2001) can affect equity markets. Chan and Wei (1996) and Kim and Mei Kim and Mei (2001) both looked at the effect of political news on the Hong Kong stock exchange and find significant effects on market volatility and returns. However, what I will use as the economic variable is the amount of FDI. In this study, I only look at Japanese outward FDI in China, as it is believed that this category best reflects the result of anti-Japanese sentiment in China.

Chapter 3: Method

In this thesis, I looked at the influence of anti-Japanese protests, which were negative political events, on economics in 2005, 2010 and 2012. Therefore the independent variable was politics, or more specifically, it is the data for anti-Japanese protests in 2005, 2010 and 2012. The dependent variable was economics, that is, the amount of Japanese FDI in China. The neo-realist hypothesis was anti-Japanese protests influence Japanese FDI in China and the neoliberal hypothesis was anti-Japanese protests do not influence Japanese FDI in China.

Main data

I used a combination of both qualitative and quantitative approaches to answer my research questions. To acquire information on three anti-Japanese protests, I used other literature, especially by Jessica Chen Weiss, the famous scholar on anti-foreign protests in China. As for information on FDI, I used the data published by the Japan External Trade Organization (JETRO), a government-related organization. This data was publically available on their website.

Analysis procedure

I compared the events data of anti-Japanese protests to the amount of FDI and examined the influence of anti-Japanese protests on FDI. To see whether these protests in 2005, 2010 and 2012 influenced the amount of FDI, I compared the FDI data in 2006, 2011 and 2013 respectively as the influence should be visible in the next year, if there was any. Then, the amount of global Japanese FDI was examined to present the deviation of the FDI in China from the norm. In order to strengthen my argument, I examined control variables, regional comparison

and other independent variables. Additional data, the sentiment of Japanese investors, both Japanese and Chinese public opinion, were presented as well.

Control variable: The United States, the United Kingdom and Thailand

The United States, the United Kingdom and Thailand were the top FDI destination countries, other than China, for Japan in 2013. These three nations have politically amicable relations with Japan, therefore they were chosen to be control variables to ascertain whether the Japanese FDI trend fluctuated in the absence of politically negative events. I collected the data from JETRO on their website, which was publically available.

Regional comparison: South Korea, Taiwan and Russia

In order to examine whether the change in FDI might be due to the regional economy, I examined the amount of South Korean FDI to China, Taiwanese FDI to China and Russian FDI to China. I used the China Statistical Yearbook, which was publicly available online in China Data Online. South Korea, Taiwan and Russia were selected mainly because these countries have historical or territorial dispute with Japan, and because they are neighboring countries and share a border in the ocean. After I looked into these additional examples of FDI with the region, I finally compared them with Japan's FDI in China to see whether trends were the same. My reasoning was that if it is the same, it means that anti-Japanese protests do not influence the amount of FDI in China and influences were just economical and regional. If the trends are different from the one with Japan and China, I concluded that the relationship between China and

Japan is different from the other regional area and protests might have influenced the amount of FDI.

Additional data

I looked at the sentiment of Japanese investors in the aftermath of the protests by using a special survey of Japanese business in China by the Japan External Trade Organization (JETRO), a government-related organization. This data is also publicly available on their website. I also looked at public opinion data from both countries to see how Japanese public opinion on Chinese people has been changing and vice versa. For the Japanese public opinion of Chinese people, I mainly used the data compiled by the Cabinet Office of Japan. For the Chinese public opinion of Japanese people, I mainly used the surveys conducted by the Institute for Japanese Studies of the Chinese Academy of Social Sciences. Finally, I studied how Chinese nationalism has been changing by analyzing the source of anti-Japanese protests.

Other independent variables: Exchange rate and FDI policy change in China

In order to eliminate the possibility of other explanations for the cause of fluctuation in FDI, I looked into 2 other independent variables. One is exchange rate fluctuation between the Chinese Yuan and Japanese Yen as it could be one of the most significant factors on determining Japanese FDI in China. The devaluation of the Yuan could enhance inflows of FDI from Japan and vice versa. I obtained the exchange rate data available online and examined closely whether the exchange rate fluctuation influenced the outward Japanese FDI. The other independent

variable is the existence of FDI policies change in China, as it could contribute fluctuation in FDI as well.

Chapter 4: Result and Analysis

In Chapter 4, I will present data of anti-Japanese protests in China and outward Japanese FDI in China and compare to see the trends. The data of the amount of global Japanese FDI, control variables, regional comparison, sentiment of Japanese investors on outward Japanese FDI in China and public opinion survey both in Japan and China about each other will follow.

4.1 Anti-Japanese Protests in China

As for the definition of anti-foreign protest, Jessica Chen Weiss (2008) uses the term “nationalist protest” and “anti-foreign protest” interchangeably in her research. She defined both terms as “A public manifestation by a group of people of disapproval or dissent, containing hostile feeling towards a foreign government or people, and rooted in advocacy or support for the nation’s interests, especially to the exclusion or detriment of other nations” (p.6-7). She stated the importance of distinction of protest from an official rally or other state-organized demonstration and defined the difference as follow:

Official rallies are organized under government or party auspices and attended by a select group of pre-screened participants. Protests—including demonstrations, petitions, marches, and strikes—may receive official permission but are organized and attended by individuals acting in a private capacity, or as part of an independent organization. Thus, the theory developed here does not encompass state-orchestrated mass demonstrations such as those in North Korea or in China during the Mao Zedong era, as those protests did not carry the same risk of turning against the regime. (Weiss, 2008, pp. 6-7)

In this thesis, three major protests are considered. The aspects of these protests that I look at are dates, duration, location, main reason, and the tiers of cities in China that had protests. According to Grace K.M. Wong and L. Yu (Wong & Yu, 2003), first-tier cities refer to “cities being granted approval by China’s central government to establish joint venture retail enterprises” (p. 62). Shanghai, Beijing, Guangzhou, and the Special Economic Zones (SEZs) are examples of first-tier cities. Also, they stated that second and third-tier cities are “those without such approvals but with good potential due to their advantageous location of being in close proximity to first-tier cities. For example, Suzhou and Wuxi are located in the Yangtze Delta in the vicinity of Shanghai, while Shantou and Zhuhai are situated in the Pearl Delta near Guangdong” (Wong & Yu, 2003, p. 62). The number of protesters is a general estimate as it is impossible to get the exact number on this item.

Event 1: Anti-Japanese Protests in 2005

On April 5, 2005, the Japanese government reauthorized the use of a history textbook that, according to critics, whitewashed Japanese war crimes of World War II especially the slaughter of civilians in the infamous Nanjing Massacre of 1937 and denied Japan’s responsibility for its wartime aggression in China. And Japanese Prime Minister Junichiro Koizumi refused to stop visiting the Yasukuni Shrine in Tokyo that honors Japanese war dead, including fourteen war criminals. On top of that, the negotiations over U.N. Security Council reform triggered the Chinese to have the protests. Due to the series of these events, a leading Bao Diao activist, who Weiss had an interview with stated “it was like pouring oil on fire” (Weiss, 2008, p. 102). Hints of protest had taken place in earlier weeks, but the official announcement for the reauthorization of

the use of a history textbook was followed by mass anti-Japan rallies across China, possibly coordinated by the Chinese government (Fisman et al., 2014).

The duration of the anti-Japanese protests in 2005 were approximately 3 weeks, from April 2 to April 17, and clustered mainly on the weekends. Weiss estimated that anti-Japanese protests happened during this period at least in 38 cities and the location varied based on the dates: On April 2-3, protests happened in the cities of Chengdu and Shenzhen, on April 9-10 in Beijing, Chengdu, Guangzhou, Shenzhen, and others, and April 16-17 in Shanghai, Shenyang, Shenzhen, and other cities across China (Weiss, 2008), and these protests happened mainly in first-tier cities. Other scholars, such as Gries, Zhao, He and Xu (Gries, 2005; He, 2007; X. Wu, 2007; Zhao, 2005) have estimated that 280 organizations and units, 107 universities, 41 technical schools, and 28,230,000 internet users signed petitions against Japan's bid for a permanent seat on the U.N. Security Council.

On Saturday, April 9, 2005, more than ten thousand students congregated in the largest mall in Zhongguancun – not to shop, but to demonstrate against Japan and what they considered its failure to properly acknowledge the atrocities it committed when it occupied China during World War II. On April 16, the largest and most violent protest occurred in Shanghai, China's most cosmopolitan city. A city government spokesman estimated the size of the crowd at twenty thousand, but some eyewitnesses believed it was as large as one hundred thousand. After three weeks of protests, the CCP finally sent clear signals that it was time to stop (Shirk, 2009). These signals include a statement by Hu Jintao to have social stability and text messages sent from the Public Security Bureau not to participate in protest.

Event 2: Anti-Japanese Protests in 2010

On September 7, 2010, a Chinese trawler collided with two Japanese coast guard vessels in disputed waters just off the Senkaku Islands, leading to the detention of the Chinese trawler captain by Japanese authorities (Wallace & Weiss, 2014). When China's repeated demands for the captain's release were refused and his detention extended for a further ten days, the Chinese government cancelled all ministerial-level meetings between the two countries. On September 24, Japan released the captain, citing in part the effect on Sino-Japanese relations. The Senkaku event brought about a series of demonstrations against Japan and Japanese products across China, beginning in October 16 and then spreading to many other cities. Protests continued to the end of October, with the final demonstrations reported on October 28. The anti-Japanese protest lasted for nearly 10 days and happened in Beijing, Tianjin, Shanghai, Chongqing, Shenyang, Changsha, Xi'an, Zhengzhou, Wuhan, Fujian, Mianyang and Deyang. Therefore, these protests happened in both first and second tier cities.

Event 3: Anti-Japanese Protests in 2012

The anti-Japanese protest in 2012 was more violent and there were greater property damage than the previous protests. According to the New York Times (Johnson & Shanker, 2012), "A factory for the Panasonic Corporation was set on fire in Qingdao, and a Toyota dealership was looted". In addition, the Japanese Embassy was attacked and there was damage to Japanese stores and restaurants in major cities. One main difference besides the intensity of the protests was that Japanese companies and business were targeted and damaged.

On July 7, 2012, the 75th anniversary of Japan's full-scale invasion of China in 1937, the Japanese government announced its intent to purchase three of the Senkaku/Diaoyu islands from their private Japanese owner. The anti-Japanese protest in 2012 happened in two waves. The early wave occurred in August, with 51 Chinese cities having at least one anti-Japanese protest. Following Japan's decision to proceed with the islands purchase on September 10, the second wave of protests took place from September 11-23. September 18 is the anniversary of the Manchurian Incident, a staged event engineered by Japanese military personnel as a pretext for the Japanese invasion in 1931 of Manchuria, and the second wave of the protest peaked on this day, with at least 128 cities having protests. In total, the protest lasted for 6 weeks, from August 15 to the end of September. Of the 287 prefectural level cities in the data, which were collected by Wallace and Weiss, 208 had at least one anti-Japanese protest, recording a total of 377 anti-Japanese protests. These protests happened in both first and second tier cities. The main reason for the protest was condemning Japan's decision to purchase three of the Senkaku/ Diaoyu islands in the East China Sea (Wallace & Weiss, 2014).

4.2 Foreign Direct Investment

Japanese FDI in China

Japanese FDI in China declined by 6.17% after the protest in 2005 and 67.54% after the protest in 2012, however it increased by 74.43% after the protest in 2010 as shown in figure 1.

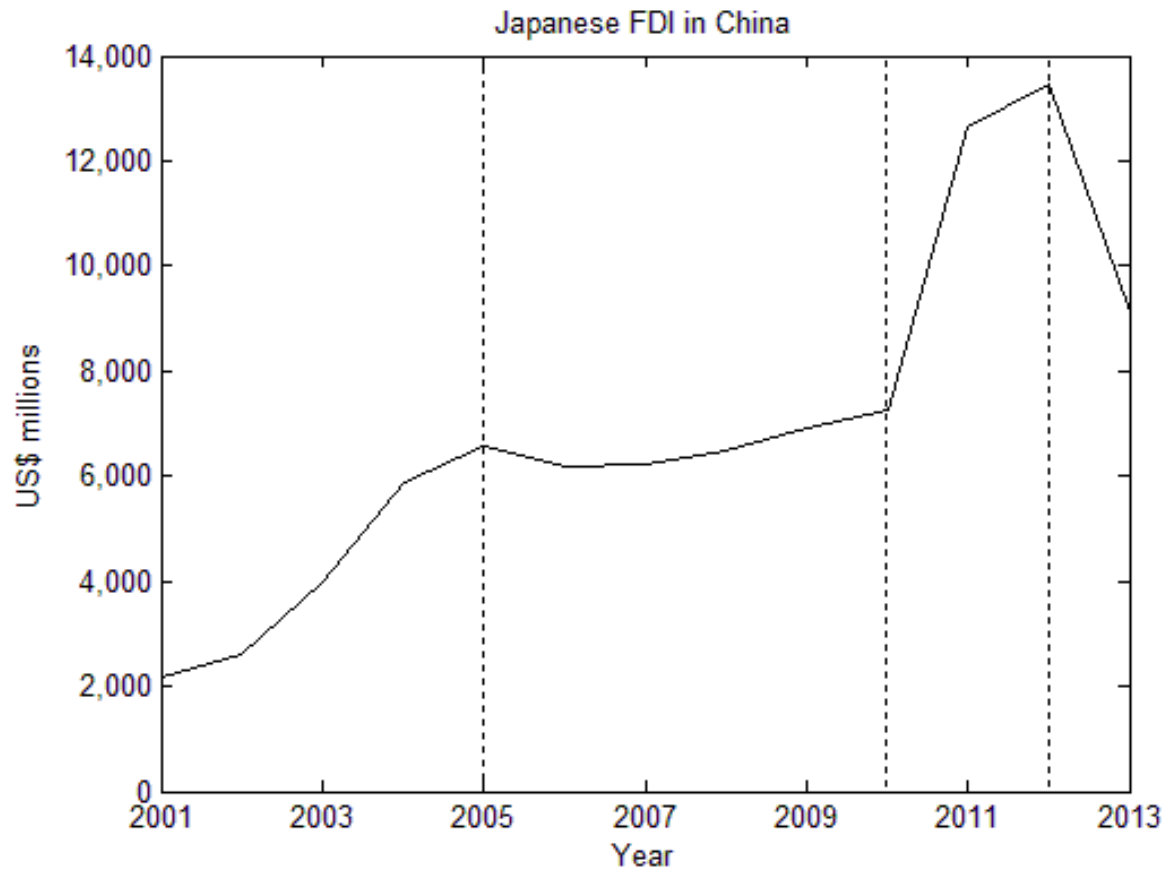


Figure 1: Japan's FDI in China

Source: The Japan External Trade Organization

Note: Each vertical dash line represents the year of anti-Japanese protests in China

Table 1 summarizes the data presented in Figures 1 and anti-Japanese protests in 2005, 2010 and 2012.

Table 1: Anti-Japanese protests data and FDI

Protest Date	Duration	Main Reason	Location in China	FDI Influence
April 2-3 to April 16-17	3 weeks	U.N. Security Council reform	At least 38 cities First-tier cities	Yes (6.17% decrease)
2010 September 8 to September 18	10 days	A maritime collision of Chinese trawler and Japanese Coast Guard's patrol boat near the Senkaku/ Diaoyu islands	At least 12 cities First and Second tier cities	No (74.43% increase)
2012 August 15 to the end of September	One month and a half	Condemning Japan's decision to purchase three of the Senkaku/ Diaoyu islands	At least 208 cities First and Second tier cities	Yes (67.54% decrease)

Source: Weiss, J. C. (2008). Powerful patriots: nationalism, diplomacy, and the strategic logic of anti-foreign protest

Global Japanese FDI

In order to indicate the deviation of the FDI in China from the norm, the amount of global Japanese FDI is presented in figure 2. It increased in all of the three years, 2006, 2011 and 2013, by 10.35 % after the protest in 2005, by 90.15% after the protest in 2010 and by 10.37 % after the protest in 2012.

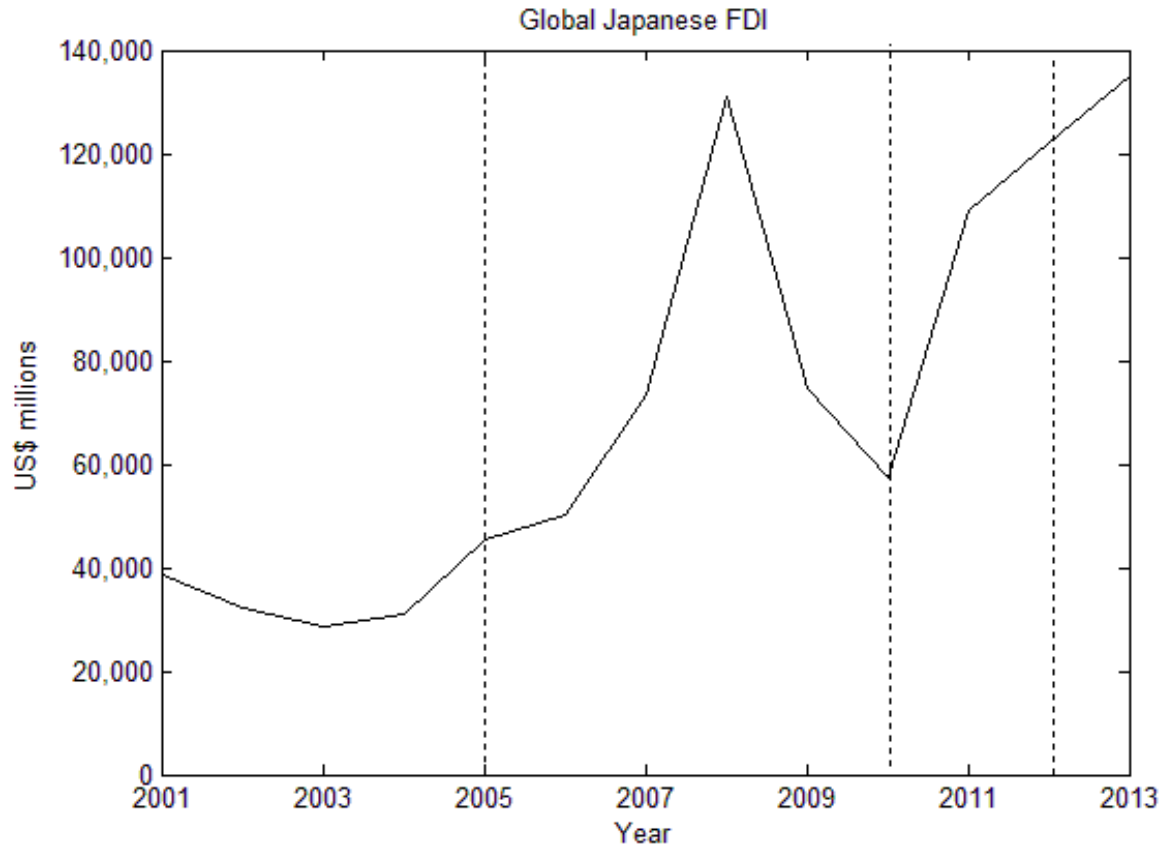


Figure 2: Global Japanese FDI

Source: The Japan External Trade Organization

Note: Each vertical dash line represents the year of anti-Japanese protests in China

Control Variable: The United States, The United Kingdom and Thailand

Three nations with which Japan enjoys amicable relations were selected to serve as control cases to explore other influences on FDI. The United States, the United Kingdom and Thailand were the top FDI destination countries, other than China, for Japan in 2013. These three nations have politically amicable relations with Japan, therefore they were chosen to be control variables to ascertain whether the Japanese FDI trend fluctuated in the absence of politically

negative events. Figure 3 depicts Japanese FDI in the United States, the United Kingdom, and Thailand, and Table 2 presents a summary of the data presented in Figure 3.

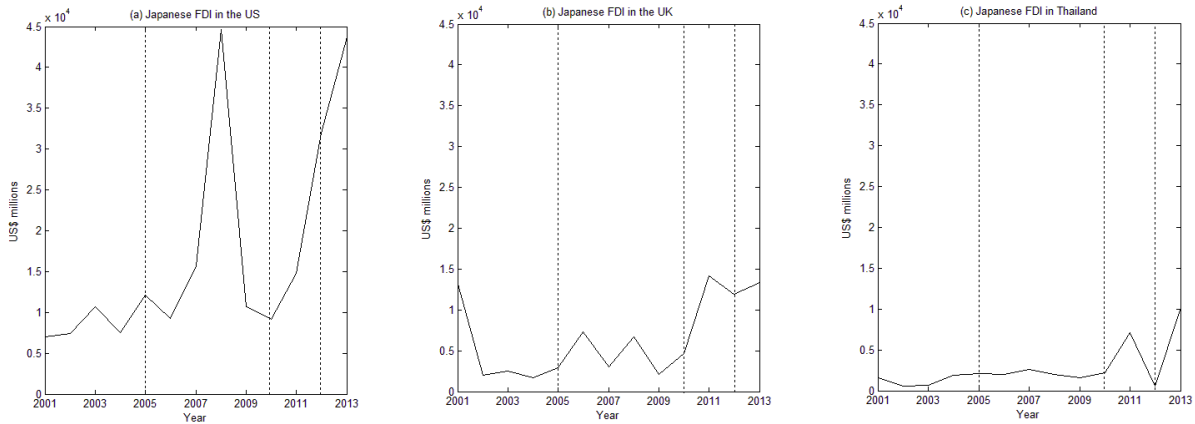


Figure 3: Japan's FDI in the United States, the United Kingdom and Thailand

Source: The Japan External Trade Organization

Note: Each vertical dash line represents the year of anti-Japanese protests in China

United States

The data (Figure 3, a) shows that Japanese FDI in the United States marginally declined after the protest in 2005 and increased significantly after the 2010 and 2012 protests. The data for Japanese FDI in the United States appears to follow economic trends. The drastic decline from 2008 to 2009 was likely related to the global financial crisis. Following a period of stabilization, FDI gradually returned to its pre-crisis peak of 2008.

United Kingdom

The data (Figure 3, b) shows that Japanese FDI in the United Kingdom increased after the protests in 2005, 2010, and 2013. Similar to the data for the United States, Japanese FDI in the United Kingdom also appears to follow economic trends. As with the United States, Japanese FDI was impacted by the 2008 global financial crisis but has since recovered to exceed its pre-crisis peak of 2008.

Thailand

The data (Figure 3, c) shows that Japanese FDI in Thailand marginally declined after the protest in 2005 and increased after the protests in 2010 and 2012. The trend in Japanese FDI in Thailand is similar to that of the United States and United Kingdom, with the exception of the significant decline in 2012. The massive decline can be attributed to the disastrous floods that inundated Bangkok in 2011. The World Bank estimated that the disaster ranked as the world's second most costliest disaster of 2011, surpassed only by the earthquake and tsunami in Japan.

The data shows that the amount of Japanese FDI in Thailand increased by 1,761%. Japanese FDI in Thailand was \$7,133 million in 2011, \$547 million in 2012, and \$10,174 million in 2013. The comparatively small amount of FDI in 2012 was an anomaly and was in response to the severe flooding that occurred from July 2011 to January 2012 in Thailand. This data point may not be valid for comparison since the decrease in FDI was likely in response to the natural disaster and its impact on the recipient nation, Thailand, rather than due to a change in the policy of the patron nation, Japan.

Table 2 summarizes the trends observed from the data presented in Figures 1, 2 and 3.

Table 2: Fluctuation in FDI from Japan to China, the US, the UK, Thailand and Global

	China	United States	United Kingdom	Thailand	Global
2006	6.17% Decrease	23.34% Decrease	150.44% Increase	6.64% Decrease	10.35% Increase
2011	74.43% Increase	60.23% Increase	205.47% Increase	217.36% Increase	90.15% Increase
2013	67.54% Decrease	36.68% Increase	12.10% Increase	1,761.30% Increase	10.37% Increase

Source: The Japan External Trade Organization

The table suggests that the fluctuation in Japanese FDI in China in 2006 and 2011 can be attributed to global concerns rather than Sino-Japan specific issues. However, the decline in FDI in 2013 appears to be unrelated to macroeconomic considerations. Additional investigation is necessary to determine the effect of regional politics on Japanese FDI.

Regional Comparison: South Korea, Taiwan and Russia's FDI in China

In order to ascertain whether the fluctuations in FDI amount were due to regional issues and to determine whether the dip in FDI in China was caused by the anti-Japanese protests or not, it is necessary to examine neighboring countries' outward FDI patterns in China and compare them with the Japanese FDI in China. Figure 4 depicts South Korea, Taiwan and Russia's FDI in China. The data of the Taiwanese and Russian FDI in China in 2013 were not available, therefore I limit the observation on their FDI in 2006 and 2011 only.

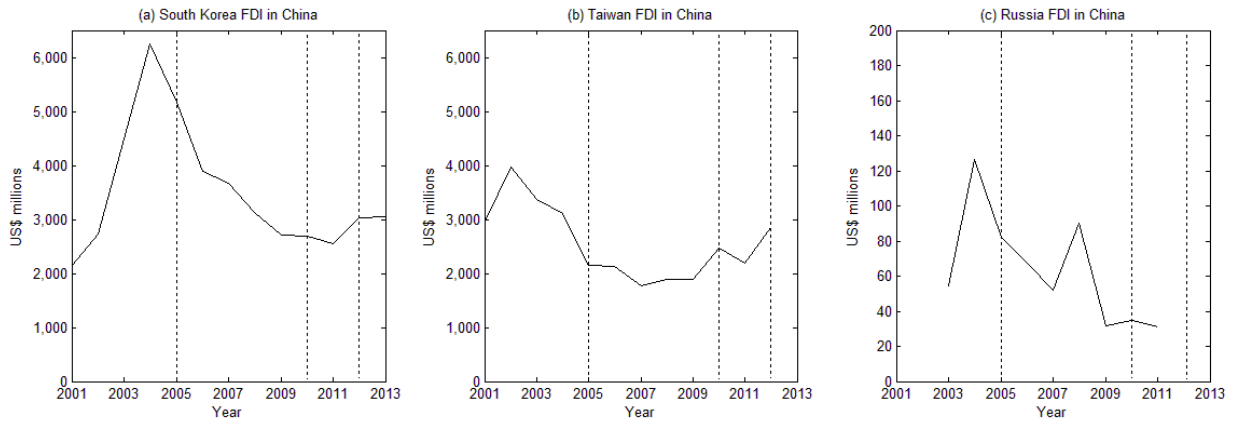


Figure 4: South Korea, Taiwan and Russia's FDI in China

Source: China Data Online

Note: Each vertical dash line represents the year of anti-Japanese protests in China

South Korea

The data (Figure 4, a) shows that South Korean FDI in China declined significantly in 2006, declined marginally in 2011, and remained unchanged in 2013. It is important to note that the declines in 2005 and 2012 were consistent with an ongoing trend in decline prior to the protests. This suggests that the decline in FDI was not specifically due to the protest events.

Taiwan

The data (Figure 4, b) shows that Taiwanese FDI in China was unchanged in 2006 and marginally decreased in 2011. There was no data available for 2013.

Russia

The data (Figure 4, c) shows that Russian FDI in China declined significantly in 2006 and declined marginally in 2011. It is important to note that the declines in 2006 and 2011 were

consistent with an ongoing trend in decline. This suggests that the decline in FDI was not specifically due to the protest events.

The data trends in Figures 4 have been summarized and are presented in Table 3.

Table 3: Fluctuation in FDI from Japan, South Korea, Taiwan and Russia to China

	Japan to China	South Korea	Taiwan	Russia
2006	6.17% Decrease	24.64% Decrease	0.74% Decrease	18.04 Decrease
2011	74.43% Increase	5.24% Decrease	11.81% Decrease	11.30% Decrease
2013	67.54% Decrease	0.69% Increase	No Data	No Data

Source: China Data Online and The Japan External Trade Organization

Tables 2 and 3 have been consolidated for ease of comparison and are presented in Table 4.

Table 4: Comparison to the Japan's FDI to China

	Japan to China	S. Korea to China	Taiwan to China	Russia to China	Japan to The USA	Japan to The UK	Japan to Thailand	Japan to Global
2006	6.17% Decrease	24.64% Decrease	0.74% Decrease	18.04 Decrease	23.34% Decrease	150.44% Increase	6.64% Decrease	10.35% Increase
2011	74.43% Increase	5.24% Decrease	11.81% Decrease	11.30% Decrease	60.23% Increase	205.47% Increase	217.36% Increase	90.15% Increase
2013	67.54% Decrease	0.69% Increase	No Data	No Data	36.68% Increase	12.10% Increase	1,761.30% Increase	10.37% Increase

Source: China Data Online and The Japan External Trade Organization

Sentiment of Japanese Investors on Outward Japanese FDI in China

The Japan External Trade Organization conducted a survey of Japanese firms in the aftermath of the 2005 protests to investigate the impact of the protests. They found that 10 percent of respondents reported being affected by the protests and an additional 37 percent were concerned about possible future impacts of worsened relations. The main concerns about the impact of the protests were: “decreased sales from boycotts of Japanese goods, a tarnished image of Japanese products, worsening relationships with Chinese employees, disruption of production activities, and increased difficulty in securing personnel locally” (JETRO, 2005). Canceling or postponing investment projects in China was mentioned by 7.5 percent, and 5.6 percent are considering the possibility of scaling down their business activities in China. That is, downsizing present production bases in China or transferring business operations to a third country. With regard to business risk in China, 44.9 percent of respondent companies believe that risks have “increased” due to the anti-Japan demonstrations, as against 40.3% that perceive such risk as “unchanged” (JETRO, 2005). This survey shows the significance of these protests on the decision making process for Japanese businesses on FDI, both on starting to invest in China and relocation their existing operation in other countries.

4.3 Public Opinion Survey Data

Only 28 percent of the Japanese and 21 percent of the Chinese had positive views of each other as of 2006 as shown in Table 5, and people in both countries consider the other competitive, greedy, and arrogant ("Publics of Asian Powers Hold Negative Views of One Another," 2006). Japan has reduced its development aid to China because its public resents China's lack of gratitude and worries about fueling China's military buildup. According to the article on China

Daily (2005b), an October 2005 poll done jointly by Chinese and Japanese organizations found 90 percent of Chinese blamed Japan for the poor relations between the two countries, while more than half the Japanese respondents said it was hard to tell which side was to blame.

Table 5: Hostility Among Asian Neighbors in 2006

Favorability rating of...	China	
	China	Japan (%)
<i>Favorable</i>	94	28
<i>Unfavorable</i>	5	71
Do Not Know	1	1
Total	100	100

Japan		
<i>Favorable</i>	21	77
<i>Unfavorable</i>	70	22
Do Not Know	9	1
Total	100	100

Source: Pew Research Center available at

<http://www.pewglobal.org/2006/09/21/publics-of-asian-powers-hold-negative-views-of-one-another/>

Japanese Public Opinion

A poll by Yomiuri Shimbun (2005a), one of Japan’s leading newspapers, conducted after the April 2005 anti-Japanese demonstrations showed that overwhelming majorities of Japanese favored taking a tough stance against China. In December 2005, eight months after the protests, they found that approximately 72 percent of the respondents did not trust China. Also, deterioration of public opinion is found on the Japanese side according to an annual poll of

“current national public opinion” as surveyed by the Cabinet Office of Japan (Figure 5). The percentage of Japanese people who “did not feel close to China” rose from 47% in 2000 to 58% in 2004, further increasing to 81% by 2013 (Office, 2004).

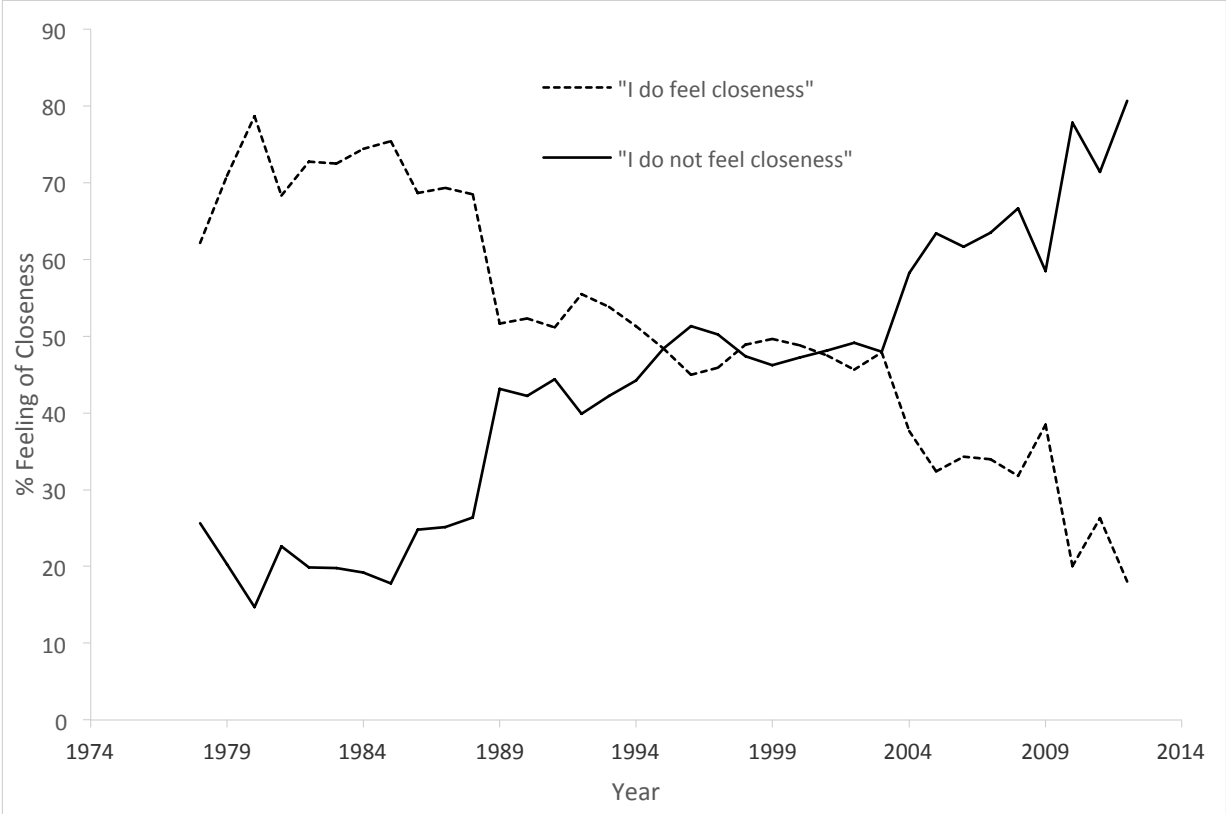


Figure 5: Feeling of closeness to China

Source: Cabinet Office of Japan

Chinese Public Opinion

Hostile attitudes toward Japan have grown in recent years, according to the national surveys conducted by the Institute for Japanese Studies of the Chinese Academy of Social

Sciences. In 2002, 43.3 percent of Chinese people said they had unfriendly feelings against Japan. In 2004, the number had risen to 52.6 percent. Much of the Chinese antipathy toward Japan is genuine and historically rooted. And the survey showed "...of those, 26 percent said they felt the way they did because Japan had invaded China, while 61.7 percent said that it was because, after five decades, Japan has still made no serious self-examination of its invasion" (2004). Yunuo Gen (2011) noted that the dislike of Japan has been simmering from its lack of repentant self-reflection regarding its invasion of and atrocities in Asia. Johnston's (1996), study found the following:

In China, the percent of urban Chinese residents who disliked Japan rose from 46% in the year 2000 to 59% in 2005. Data measuring Chinese feelings of amity on a scale of 1–100 (higher values indicate more positive feelings) show that Chinese amity toward Japan dropped from neutral levels of 50 in 1998 during the first year of the survey to a low of 30 in 2004. (p 638)

4.4 Evaluation of Other Possible Independent Variables

Exchange rate, Japanese Yen per 1 Chinese Yuan

Xing and Wan (2006) analyzed the role of exchange rates in the competition for FDI and they suggested that, "if the currency of one FDI recipient country appreciate against the currency of the sourcing country more than that of its rival, its FDI inflows will decrease while the FDI flowing into the competing country will increase" (p. 1). Other literatures also indicate the importance of the exchange rate in determining FDI (Blonigen, 1997; Froot & Stein, 1992; Klein

& Rosengren, 1994). According to Xing and Wan (2006), “a devaluation in the currency of the recipient country reduces production costs, measured in foreign currency, and increases the relative wealth of foreign investors, leading to an increase in FDI inflows” (p. 3). In line with these studies, Abbott et al. (2012) showed that developing countries with more fixed and stable exchange rates tend to have greater levels of FDI than countries with flexible or floating exchange rates. When examining 70 countries from 1984-2005 including China, they found that more stable exchange rates attract greater FDI. While the Chinese yuan has increased in value over the last ten years, it has remained stable and slowly increased rather than significantly fluctuate over time. Between 2003 and 2013 the exchange rate averaged about 14 Japanese yen to the Chinese yuan. After the 2012 protests, the rate changed from 13 to 16. This was a minimal change.

Looking at the difference in exchange rates between 2004-2005, 2009-2010 and 2011-2012, I found no significant fluctuation in the value. As the literature suggests, the relatively stable exchange rate did not play a role in the massive fluctuation of the amount of FDI after 2012.

FDI policies change in China

Government’s policy towards FDI plays an important role in attracting FDI. In the 1950s and 1960s, China was isolated from other countries due to political reasons. Since 1978, China has adopted reform and an opening up policy. Chinese government encourages FDI to develop China’s economy. China promulgated the Sino-China Equity Joint Venture Law in 1979 and the Foreign Capital Venture Law in 1986. After China joined the WTO in 2001, China reduced or abolished some performance requirements and other restrictions on FDI. However, there were no

new economic policies directly related to FDI implemented in the years of 2005, 2010 and 2012, therefore I argue that FDI policies in China did not play a role in the fluctuation of the amount of FDI during the period that I studied.

4.5 Analysis

The data presented in Table 4 suggests that macroeconomic trends and natural disasters were highly likely to affect Japanese FDI over the time interval of concern. International FDI broadly declined in 2006, was mixed following the 2008 financial crisis, and broadly increased following recovery from the crisis. Japanese FDI in China was an exception to the broad international increase in FDI in 2013. It is likely that the larger magnitude, longer duration protests that occurred in 2012 over contentious contemporary and historical issues contributed to dramatic decreases in the amount of Japanese outward FDI in China.

The FDI data provides circumstantial evidence for the theory that anti-Japanese protests influence the amount of Japanese FDI, which supports the neorealist hypothesis. Other independent variables, such as currency exchange rates, FDI policy changes, and regional factors were found to have no significant effect on Japanese FDI in China. While the data analysis applied limited control variables, the results are suggestive. Although investment decisions are complex and take into account many factors, the decision to dramatically contract Japanese FDI to China in late 2012 and early 2013 appears to be a direct economic response to the 2012 political protests.

Chapter 5: Discussion

My contribution to the literature is threefold. First, I presented contemporary data by reviewing data from 2001 to 2013. Second, the specific variables that are unique to China and Japan were evaluated. Third, I studied the amount of Japanese outward FDI to China to study the economic effects of politics. My purpose for this paper is to determine whether politics influences economics between these specific countries.

The results support the neo-realist theory that politics trump economics during periods of heightened political tension. Despite the relatively high level of economic integration, China and Japan appear to prioritize their political relations over economic relations during periods of tension. Therefore, politically negative events such as anti-Japanese protests in China could influence the amount of Japanese FDI in China depending on the magnitude of the protests.

This study has two important limitations. The first limitation is regarding the number of people that participated in the protests. Due to the inherent difficulty of gathering accurate and complete demographic data for the number of participants, media and some government sources have rarely reported their overall size. The second limitation is the lack of other possible explanations for the fluctuation of the amount of Japanese FDI in China. Although I looked at exchange rates and tax policy changes in addition to regional trends, there could be many other determinants of Japanese FDI in China such as market size, cost of capital, wages and exchange rates, etc. Nevertheless, this study's conclusion suggests that it is possible to assume that these negative events might influence the amount of FDI.

Despite the limitations of this study, a key point can be taken from this project. That is, both China and Japan would benefit from an amicable relationship. After all, they have the most to gain from the creation of, or most to lose from the lack of, the amicable relationship. Amicable

relations could then promote mutual advantages in terms of developing their economies and lessen any conflicts that do arise.

I informed that there are mainly two controversial issues that Japan and China have at the moment; how Japan has dealt with the atrocities it committed during World War II and the dispute over the Senkaku/ Diaoyu islands. This study finds that history is important and the acrimony about the interpretation of the Sino-Japanese War very much influences present and likely future relations between China and Japan. If what happened in the past between China and Japan hinders economic opportunities and how Japanese politicians have dealt with is the key point, Japan should make an effort to harmonize relations with China. Not only should Japanese politicians consider the sincerity of their statements of apology for what Japan did to China, they should support their action by discontinuing their visits to Yasukuni shrine to honor the Japanese war dead who committed war atrocities against the Chinese people. Although this idea will be unpopular among Japanese nationalists, it is necessary for Japan to take this action if it will improve relations. In addition, Japan should change the contents of their history textbooks to include Japanese war atrocities. This would serve as an acknowledgment of the events and Japanese youth would have the opportunity to know about their history.

As for Chinese side, when Chinese people have anti-Japanese protests, nationalism plays one of the major roles in motivating them, as they are motivated by nationalism as much as by anger about Japanese action. Nationalistic education in China, especially portrayed in “patriotic education campaigns”, promotes potentially destructive nationalism amongst Chinese people. Excessive nationalism in Chinese people may have the potential to harm their own economy and development. However, it should be left to the CCP to determine the acceptable degree of nationalism in Chinese citizens. I would argue that the Chinese educational system controlled by

the CCP is a key for China and Japan to have a better relationship in the near future. It should be noted that the exam-based format of schooling might deter creative thought and, therefore, make it easier for nationalistic sentiments to flourish (Geng, 2011). On the other hand, education has the potential to foster in youth the ability to understand multiple points of view. If Chinese youth could learn the Japanese point of view and Japanese youth could learn the Chinese perspective, China-Japan relations might be much improved.

The data suggest that anti-Japanese protests can have a negative influence on the Chinese economy when Japanese FDI diminishes. Over the last 20 years and especially after the 1997 massive closure of state owned industries in China, there has been a rise in anti-Japanese rhetoric at Chinese universities and in the media. Indeed, the relatively recent increase in the protests coincides with the social changes in China regarding reduced state support for urban workers following the closure of state industries. As Zhao (1998, 2005) and Shirk (2009) suggest, the CCP seems to be the driving force behind rising nationalism and even anti-Japanese themes in media and education. In 2005 and 2010, the CCP witnessed anti-Japanese protests without any economic repercussions from Japan in terms of trade or FDI disruption. However, the larger and more destructive 2012 protests seem to have a negative influence on Japanese FDI and Japanese business invested less in the immediate aftermath of the protests. Scholars suggest that the CCP rely on economic development and nationalism for political legitimacy, but in the past these tended to be relatively separate phenomena that did not overlap or clash. This study suggests that increased nationalism in the form of anti-Japanese protests can have a negative influence on the economy. This may not bode well for the CCP in the long run.

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