



# China's Use of Economic Punishment Strategic Signalling, Red Lines and Returns

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## **China's Use of Economic Punishment: Strategic Signalling, Red Lines and Returns**

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### **KEY TAKEAWAYS**

- *China will continue to use economic punishment as long as it remains a credible signalling tool.*
- *China's willingness to absorb the costs of such punishment reflects a calculated trade-off.*

### **COMMENTARY**

On 6 January 2026, China's Ministry of Commerce [announced](#) new export controls on [dual-use items destined for Japan](#). The move was widely interpreted as a punitive response to Japanese Prime Minister Sanae Takaichi's remarks regarding Japan's potential role in a [Taiwan contingency](#).

China's latest retaliation against Japan is not unfamiliar. It echoes a playbook first tested in 2010, when Beijing imposed a [ban on rare-earth exports](#) to Japan following a collision near the disputed islands, which the Chinese call Diaoyu and the Japanese refer to as Senkaku. That episode marked not only a diplomatic crisis but also a turning point in China's rare earths policy. What had been [a fragmented and poorly regulated](#) rare earths sector was subsequently consolidated under tighter state control, and Beijing began to recognise that its dominance in critical supply chains could be [leveraged](#) for geostrategic ends.

Since 2010, China's growing interest and capacity in wielding economic statecraft have fuelled a growing literature [questioning the effectiveness](#) of China's economic coercion. Measured narrowly, sanctions [often fail to achieve](#) their immediate objective of changing the target country's behaviour. In the latest scenario, Japan is [unlikely to revise](#) its Taiwan-related statements. China also failed to secure compliance in cases

such as stopping Lithuania's [decision to allow Taipei](#) to establish a representative office or Seoul's decision to [host US THAAD](#), an anti-ballistic missile defence system. Likewise, it could not pressure Australia to reverse its [call for an international probe](#) into China's handling of COVID-19.

Increasing use of economic coercion will [harm China's reputation](#) as a credible trading partner. Also, repeated use of economic measures has prompted adaptive responses. The 2010 rare-earth embargo left Japan [acutely aware](#) of its supply-chain vulnerability and prompted it to diversify, invest and stockpile alternative sources despite higher costs. Australia too has [redirected its exports and pursued alternative markets](#). By the same token, [advanced economies](#) like the European Union have developed institutional frameworks for economic security and risk mitigation to [reduce their reliance](#) on China.

Since China's economic pressure often fails to compel compliance, why does Beijing continue to rely on it?

### **Ready to Accept the Trade-offs**

Judging effectiveness solely by whether a target changes policy misses Beijing's broader intent. China's continued reliance on economic punishment suggests a deliberate acceptance of the trade-offs involved. First, compared with military options, economic coercion allows China to demonstrate firmness in its core interests while managing strategic flexibility to control risks. Measures like trade restrictions, regulatory delays or tourism controls can be adjusted, expanded or relaxed over time. Past records have shown that China eased trade barriers it had imposed on trading partners such as [Lithuania](#) and [Australia](#).

However, this time, Japan's experience as the target of China's latest export control serves as a cautionary tale for others, particularly US allies and partners weighing their relationship with Taiwan. The message Beijing seeks to convey is that once codified through legal instruments, such export control measures are difficult to reverse and unlikely to lapse when China's sovereignty-defined red lines are crossed. In this sense, the primary audience of economic coercion is not just the targeted state, but third parties observing the costs imposed. The Chinese state hopes that serious export control measures will send clearer deterrence to parties that challenge China's core interests and shape the behaviour of third countries towards exercising more caution in pursuing policies and narratives concerning issues that China defines as core interests.

Second, economic coercion provides benefits of immediate signalling on politically urgent and sensitive issues that touch on sovereignty, territorial integrity and regime legitimacy. Economic sanctions indeed result in domestic costs. However, over the years, China has demonstrated skilful tactics and confidence in managing the costs arising from trade disruption. For instance, a boycott of overseas tourism could [redirect consumer spending into the domestic market](#).

Importantly, China is more adept at leveraging its dominant role in the supply chain. Take rare earths as an example. In 2024, China supplied [around 60%](#) of the global mining output of rare earths used in magnets for various industries. Its leverage is

even more pronounced in the downstream sector, where China controls [approximately 91% of global separation and refining capacity](#). During the US–China trade war, [rare earths re-emerged as a trump card](#) for China as a potential countermeasure against American pressure. As long as significant asymmetries remain, economic punishment retains its potential, even if trading partners such as Japan, Australia and others have accelerated supply-chain diversification.

In fact, Beijing appears willing to accept market diversification by its Western trading partners. From Beijing’s perspective, diversification by advanced economies was already under way owing to geopolitical tensions. As Chinese leader Xi Jinping pointed out, “it is necessary to adhere to the [bottom-line \(底线思维\)](#) and to make both *mental and operational preparations* for a prolonged period of changes in the international environment”. The emphasis on mental preparation implies the Chinese leadership has instructed domestic players to think from a strategic vantage point about [how to prepare in advance and respond effectively](#). The instruction on operational preparation shows the top leadership [expects](#) domestic players to take the initiative to prepare contingency plans in an effective manner while organising resources in response to both immediate and medium- to long-term challenges in the international environment.

Accordingly, China has implemented the “[dual circulation](#)” strategy to reduce vulnerability by strengthening domestic demand, indigenous innovation and supply chains. China has also accelerated the diversification of its own economic engagement towards the Global South and non-Western countries. Trade and investment ties with Southeast Asia have deepened substantially, with the region now serving as China’s [largest trading partner](#). Beijing has also expanded resource and energy partnerships in the [Middle East, Central Asia, Africa and Latin America](#). In parallel, China has promoted [South–South development finance](#) and bilateral investments through its Belt and Road Initiative to lessen the decoupling pressure from the advanced economies. In fact, the latest data shows that China’s trade relations at the global level are resilient as its annual trade surplus has reached a [record high](#) despite ongoing trade tensions with the United States.

These outward diversification strategies help explain Beijing’s greater tolerance for diversification by advanced economies. Therefore, accepting some erosion of long-term market share becomes a calculated trade-off in exchange for clearer deterrence to parties that challenge China’s core interests.



China is willing to accept some long-term market share erosion to strengthen deterrence against challenges to its core interests. *Image source: Unsplash.*

Third, refraining from any punishment or inaction risks the Chinese party being perceived as weak or ambiguous in its response to third party provocation. Economic punishment reassures domestic audiences that red lines have been drawn while demonstrating that export controls are designed as a firm instrument for defending China's core interests. Moreover, a symbolic or superficial punishment of the target government may ultimately undermine Beijing's effort to project firmness and resolution in defending its core interests, although such behaviour could discredit itself as a reliable trading partner.

While some existing work suggests the World Trade Organization (WTO) [has an effect](#) on China's economic coercive behaviour as the multilateral trading system enforces fair trade rules. Frequent use of economic sanctions, even in the name of security exceptions, ultimately undermines the WTO's rules-based system and causes broader trade instability. While China has pledged to [continue to support the WTO](#), it has grown increasingly sceptical of the multilateral trading system. Beijing has drawn lessons from Washington's frequent use of sanctions and trade wars against other countries, observing few immediate or meaningful backfires in the US case.

Moreover, reputational damage resulting from economic coercion now carries much less weight in China's policy calculus when its core interests are at stake. [Negative public opinion of China](#) in Western countries such as the United States, Japan, Australia, Canada and parts of Europe is already entrenched and is often perceived in Beijing as a [long-standing bias against China](#), leaving Beijing with little additional goodwill to lose. As a result, the reputational costs of imposing coercive measures on trading partners that challenge its core interests appear relatively low for China. Together, these perceptions have weakened China's confidence in the rules-based system and reinforced the belief that unilateral economic measures can be deployed with manageable costs.

## Conclusion

Overall, Beijing seems willing to accept economic losses, reputational damage and market diversification by trading partners in order to achieve short-term deterrence and clear signalling. For Beijing, economic punishment is not judged solely by whether it forces immediate policy reversal, but by whether it communicates resolve, clarifies red lines and imposes visible costs. The calculated efforts show Beijing's intention in shaping the international environment around its core interests. As long as such measures retain signalling value, particularly on sovereignty and security issues, China has strong incentives to keep using them.

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