

Sino-Japanese Economic Relations : Issues and Prospects

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1. Introduction

China's successful implementations of economic reform and opening-up to the outside world since the end of 1970's have resulted in a significant growth of its output and international trade. According to the official Chinese statistics, from 1980 to 1995, the nominal value of exports grew by 14 percent per year, while the real GDP grew by 10.2 percent annually. The rapid growth of exports, combined with devaluation of the Chinese *yuan*, pushed the ratio of the export dependency, i.e. the ratio of merchant exports to GDP, from 6 percent in 1978 to 11.8 percent in 1988 and to 21.7 in 1995. In 1977, China was only the 30th largest exporting country in the world, and its share of world trade in that year was only 0.6 percent. By 1995, however, China was the world's 10th largest exporter, lagging behind only the largest industrialized states, and its share of world exports had exceeded 3 percent.

Prior to the later 1970s, China was inactive in world capital markets. China was not a borrower either from international financial organizations or in international commercial markets. China was not a recipient of foreign capital, either bilateral development agencies nor private foreign direct investment, and did not invest abroad. By the middle 1990s, however, China has become a significant recipient of foreign aid and a major borrower on international capital markets. China has been attracting substantial inflow of foreign direct investment, and sold large quantities of bonds on international credit markets.

China's trade and other foreign economic relations are overwhelmingly concentrated in the Asia Pacific area. The Asia Pacific Economic Cooperation (APEC) group of economies includes all China's most important trading partners and accounts for more than 80 percent of its import and export trade. Among them are the United States and Japan. While the Sino-American economic relations are not

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free from problems, such as the human right issues, arms sales, intellectual rights, and market access for US products on China, etc., Sino-Japanese economic relation seems relatively smooth and are basically driven by market forces. Japan has been an important partner of China's growing towards a globe economic power. Japan is now the single largest trading partner of China, and the third largest FDI supplier in China. Japan's Official Development Aid to China through the Japanese Overseas Economic Cooperation Fund (OECF) has been the main source of China's inter-government borrowing. From the Japanese side, China is now the second largest trading nation, and is also the second in receiving FDI from Japan, next only to the United States.

The organization of this paper is as following: section 2 provides a brief examination of developments of Sino-Japanese economic relations since China's opening up, focusing in the fields of trade, investment and lending. Section 3 discusses the rule of Japan in accommodating China into the world economic community, and implications to the emerging order of the Asia and Pacific economic cooperation.

2. Sino-Japanese Economic Relations : A Brief Survey of Evidences

(1) International Trade

Table 1 displayed China's major trading partners in 1996. Japan ranked number one in bilateral trading relations with China, accounted for 20.7 percent of China's total trade flow, 20.5 % of China's export and 21.1 % of the import of the year. According to the statistics of Minister of Finance (MOF) of Japan (differences between the Chinese and Japanese trade statistics will be discussed bellow), China accounted for only 3.1 percent of the total Japanese imports and 2.9 percent of the total exports in 1978, the year when China started transformation to reform and opening policy. The corresponding numbers were 10.9 % and 4.7 % in 1995 respectively. Bilateral Sino-Japanese trade is growing so rapidly that since 1993, China has become Japan's second largest trading partner, compare with the fifth largest one in 1992. China surpassed Germany, Taiwan and South Korea in importance as trading partners of Japan, next only to the USA.

According to the Chinese statistics, trade relation between China and Japan was basically balanced in 1990s. (see Table 2) This consists a sharp contrast with other major trading partners of China. For example, in 1996, China recorded 25.1 billion dollars trade surplus with Hong Kong¹⁾, 10.5 billion dollars surplus with

Table 1. China's Major Trading Partners in 1996 (B\$)

	Total	Chinese Export	Chinese Imports
Total	289.9	151.1	138.8
(1) Japan	60.1	30.9	29.2
(2) United States	42.8	26.7	16.2
(3) Hong Kong	40.7	32.9	7.8
(4) Korea, R.	20.0	7.5	12.5
(5) Taiwan	19.0	2.8	16.2
(6) Germany	13.2	5.8	7.3
(7) Singapore	7.4	3.8	3.6
(8) Russia	6.8	1.7	5.2
(9) Australia	5.1	1.7	3.4
(10) Italy	5.1	1.8	3.2

Source : General Administration of Customs of the People's Republic of *China*, *China's Customs Statistics*, 1997. 2.

the United States. On the other hand, Taiwan, South Korea and Russia had considerable trade surpluses over China. Nevertheless, Japanese trade statistics showed that Japan ran trade deficits with China in recent years. (Table 2)

The gap between the two statistics is too large to be accounted for only by the deference between CIF and FOB. The Chinese trade data included a part of the transshipment through Hong Kong, While the Japanese export to China may be

Table 2. Comparison of Trade Statistics (B\$)

	Japanese Statistics	Chinese Statistics
Chinese Import 1994	19	26
1995	22	29
1996	22	29
Chinese Export 1994	28	22
1995	36	28
1996	41	31

Source : General Administration of Customs of the People's Republic of China, *China's Customs Statistics*, and Minister of Finance of Japan, *Foreign Trade Statistics of Japan*, various issues.

Table 3. Changing Structure of Japanese Import from China (%)

	1980	1990	1996
Food	15	17	13
Raw Materials	19	11	4
Crude Oil	34	12	4
Manufactured Goods	26	49	73
Machinery	0	6	18
Textile	16	29	34
Chemical	4	5	4

Source : Minister of Finance, Japan.

significantly underestimated due to export through Hong Kong. In Japan, export is classified according to final destination of goods and import according to the origin of the goods. The problem is that when the final destination is undecided at the time of export, the first destination is used for the statistics.

Despite this discrepancy in statistics, the fact remains true that Japanese import from China has

increased very rapidly in the first half of 1990s. According to the Japanese data, it was 12 billion dollars in 1990 and 41 billion in 1996, accounted for more than one-fourth of the total Japanese import growth during this period.

The trade expansion has been accompanied by a significant change in commodity structure. As table 3 shows, the import growth has been driven by the rapid increase of the imports of textile and machinery products. The textile imports accounted for 34 percent of the total Japanese import from China, and consisted more than half of the Japanese total textile import in 1996. The fact that Japan has not use the MFA to limit the import of textile products from developing countries has promoted this development. This rapid increase of Japanese import of labor-intensive manufacturing goods from China, has reflected a deep change in China's economic development strategy from a autarky one in pre-reform period to a more opened one inline with the comparative advantages of the Chinese economy, as well as the shifting competitiveness of the Japanese economy from labor-intensive industries to capital and knowledge intensive products.

It should be noted that the surging of the Japanese import from China has been partly a product of the shifting of Japanese production sites into China. A notable feature of the Japanese direct investment in China is a relatively high proportion of its production being exported back to Japan. According to a survey conducted by MITI in 1995, about 30 percent of the sales of the Japanese-invested firms in China was exported to Japan. In terms of textile sector, this ratio was as high as 81 percent. A trade-investment chain has been formed, through which a increase in

investment will cause expanding of trade flow both in import and export. Recent surge of the Japanese FDI in China suggests that the rapid growth of manufacturing goods import from China, as well as export of capital goods to China will continue in coming years.

(2) Japanese Direct Investment in China

The presence of Japanese firms in East Asia has been growing, and the behavior of the firms also has been changing over time. In the period of later 1960s to early 1970s, at the requirements of import substitution industrialization of the host countries, Japanese-invested firms in East Asia greatly contributed to the expansion of domestic markets of these economies. Since late 1970s, because of the sharp

Table 4. Japanese Foreign Direct Investment in China, 1979-96
(project, M\$)

	Japanese Statistics		Chinese Statistics	
	project	Million\$	project	Million \$
1979-83	27	73	27	950
1984	66	114	138	203
1985	118	100	127	471
1986	85	226	94	210
1987	101	1226	113	301
1988	171	296	237	276
1989	126	438	294	440
1990	165	349	341	460
1991	246	579	599	812
1992	490	1070	1,805	2,172
1993	700	1691	3,488	2,960
1994	636	2565	3,018	4,440
1995	770	4592	2,946	7,592
1996	365	2600	1,742	5,130
sum (1979-96)	4,066	15,919	14,969	26,417

Sources : the Chinese data is from Minister of Foreign Economic Relations and Trade, and the Japanese data is from the Minister of Finance of Japan.

*Japanese fiscal year starts from April 1st.

increase in labor and land cost in Japan, increasing number of Japanese firms, being afraid of losing competitiveness in international markets, began shifting to the East Asia in order to seeking for cheap labor and land. Since 1986, when Japan experienced a sharp real appreciation of Yen in the Plaza accord, more and more Japanese manufacturers tried to build their export production bases in neighboring economies, for the purpose of re-exporting the products to Japanese domestic market. Recently, as East Asia markets getting more and more mature, business opportunities of Japanese firms in terms of selling products and purchasing materials and inputs in this area enlarged, increasing number of Japanese investors began to re-investment with profits raised in host countries instead of sending profits back to Japan. Localization of the Japanese-invested companies has been taking place in East Asia.

The evolution of Japanese direct investment in China has reflected the changing pattern of the Japanese firms in East Asia. Table 4 recorded annual data of Japanese FDI in China, both Chinese and Japanese statistics. The Japanese data series is systemically lower than the Chinese one, reflecting the fact that a part of investment in China did not reported to the Japanese MOF. As shown in the table, the Japanese FDI in China remained at a relatively low level until 1983. It gradually increased since then, and dramatically accelerated after 1991, reached a peak in 1995. According to the Japanese statistics, the number of projects of Japanese FDI in China in 1995 fiscal year was 770, ranked top among all the host countries of Japanese FDI, and the total value amounted 4.6 billion dollars, second only to the USA as a host country.

Although the recent surge is quite impressive, comparing to Japanese FDI in other East Asia economies, the extent of Japanese investment in China relative to the size of economy (either in terms of population or of GDP) is still relatively moderate. Furthermore, the average size of project in China is significantly smaller than that in other East Asia countries. For example, the average amount of manufacturing investment in China in 1995 was less than 6 million dollars (almost doubled 1994 figure), while in ASEAN regions the same value amounted 10.3 million dollars. China's stock of Japanese FDI fell significantly short of the other East Asia economies, reflected the relative unfavorable investment environment in China, and the rigid entry regulations of the Chinese government toward foreign investment in fields such as automobile, trade, transportation, finance etc., of these industries Japan has strong international competitiveness.

(3) Japanese Official Development Assistant to China

One of the important aspects of Sino-Japanese economic relation which deserves special attention is the considerable size of Japanese bilateral economic assistance to China. (Table 5) Since the opening up to the outside world in the end of 1970s, China eventually receives official development assistance in forms of low-interest and long-term loans, as well as grants from the major industrialized countries. Japan has been the single most important source of the funds, accounted for more than half of the official assistance China received since 1979.

Japan has extended three major OECF assistance packages to China in the period of 1979 to 1995, with loans totaling more than 10 billion dollars. The loan funds are basically no-tie, and disbursed in annually base to finance the

specific projects, such as transportation, power station, environment protection and chemical fertilizer plants, etc., proposed by the Chinese government. These Japanese-assisted projects have greatly contributed to the improvement of China's infrastructure, and helped alleviating bottlenecks in China's economic growth.

Table 5. Japanese Annual Bilateral Disbursements to China (millions of dollars)

	Total	Grants	ODA loans
1979	2.6	2.6	—
1980	4.3	3.4	0.9
1981	27.7	12.1	15.6
1982	368.8	38.6	330.2
1983	350.2	51.1	299.1
1984	389.4	41.5	347.9
1985	387.9	42.7	345.2
1986	497.0	86.9	410.1
1987	553.1	130.3	422.8
1988	673.7	154.7	519.0
1989	832.2	164.1	668.1
1990	723.0	201.2	521.7
1991	585.3	194.1	391.2
1992	1,050.8	259.5	791.2
1993	1,350.7	299.5	1,051.2
1994	1,479.4	346.3	1,133.1
1995	1,380.2	387.9	992.3
sum	10,656.0	2,416.5	8,239.5

*The Japanese fiscal year begins 1st April.

source: Japan Minister of Foreign Affairs, White Book on Japanese ODA, various years.

3. Sino-Japanese Economic Relations in the World Perspective

As shown by the above examinations, Sino-Japanese economic relations have

developed rapidly since the opening-up of China. Trade and investment flows have shown a substantial growth, and remarkable structural changes have occurred continually. The driving forces of the economic integration of the two major economies can be summarized as following: the deepening of market-oriented reforms and rapid economic growth in China have paved way for strengthening the economic linkages with the outside world, and the rapid change of Japanese economic structure has provided strong incentives to the Japanese business circle for seeking opportunities with the growing Chinese market. The deepening of economic ties between the two countries has based upon the strong complementarity of resources and industries of the two economies, and driven mainly by market forces, rather than government manipulations.

This does not mean that there is no room for government to play an important rule in enhancing external economic relations. In case of Sino-Japanese relations, as a matter of fact, the governments concerned have played a supporting rule in promoting mutual economic transactions. Japan has been providing to China the MFN status since 1974, when the two countries signed a bilateral treaty on trade relations. The treaty obliges both countries to provide MFN treatment to its counterpart. Japan and China also signed a bilateral investment protection treaty which became effective in 1989. The two governments agreed to guarantee both the MFN and National Treatment for business transactions for each other.

In his 1994 visiting to Japan, Chinese vice-premier *Zhu Rongji*, urged accelerating Japanese FDI in China, and called out to further increase the bilateral trade to five times of current level in the foreseeable future. *Zhu's* prospect was welcomed by business leaders as well as government officials in Japan. It is commonly perceived in Japan that China has maintained a relatively high protection on those goods in which Japan has strong international competitiveness, and the further development of investment has been limited due to China's entry regulation. Therefore, Japan has a strong interest in the development of trade and investment liberalization in China, and a closer Sino-Japanese economic linkage will benefit China to form a more transparent and rule-based business environment, which will be essential for China in its increasingly importance of engagement in the world economy.

In the last two decades, East Asia has been the most rapidly growing portion of the world economy, offering a great potential for the expansion of the world trade and capital utilization. Within the East Asia, China offers increasing business

opportunities, and is growing into one of the major trading nations of the world. Like Japan, China's involvement into the world economy is full-raged and multi-directional. Sino-American economic relations has a vital importance to China's national interest and international presence. Issues relating to the ongoing economic integration of the so-called Chinese circle, namely Mainland China, Hong Kong and Taiwan, have always been the major concern of the Chinese policy makers. In a sense, while the development of Sino-Japanese economic relations is of great importance and offers tremendous benefits to both countries, itself is by no means special. Both China and Japan have great interests as well as responsibilities in maintaining a open and free world trading system, and this in turn, will contribute to the strengthening of the economic relations between the two countries.

[NOTES]

- 1) It is believed that a considerable part of Chinese export to Hong Kong was destined to the US, this made China's trade surplus over the US even larger than the Chinese official statistics would suggest.