

# Sino-Japan Trade

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## 1. Introduction

This paper has been prepared to better understand the trend and main points of Sino-Japan trade from 1945 to 2004. This period of 60 years can be divided into 5 stages :

- a) A confused stage due to the Chinese civil war ;
- b) A politically influenced stage under non-diplomatic relations ;
- c) A normalized stage following 1972 ;
- d) A substantially developed stage following 1992 ;
- e) The state of Sino-Japan trade in 2002 and 2004.

Geographically, Japan and China are neighboring countries, in terms of trade, both nations can be considered complimentary. However, a small trade volume between the two countries existed between 1945-1972 due to an “irregular situation”. The Chinese civil war and the change of the government in Mainland China in 1949 had a profound impact on the trade between the two countries. Following 1949, China took an “eastern” perspective, while Japan looked to the West. China’s policy made use of trade with Japan for political purposes. The relationship between the two countries changed from this “irregular situation” to a more regular situation in 1972. We can follow the trends in trade on one hand by statistics and by events related to the trade on the other hand.

The two-way trade between the two countries grew from 1.1 billion US\$ in 1972 to 101.5 billion US\$ in 2002. From the standpoint of Japan, the trade with China was small and almost negligible in 1972. Now the trade is one of the most important economic compositions of each nation and quite complimentary.

Let us examine the reasons for this rapid development of trade in recent years. Synchronization of Japanese foreign direct investment (FDI) and the trade is obvious. The more Japan increases FDI into China, the more Japan imports from China. There has been a Japanese trade deficit with China since 1988. And the deficit value has basically increased, becoming quite significant. More imports from China help Japan to make a more advanced society. Still, Japan has an overall trade surplus with the rest of the world amounting to more than 100 billion. At the same time, a mutually heavy dependence on the trade at present exists.

In this paper, we can see Sino-Japan trade history mainly based on Chinese trade statistics

A Brief Chronicle of Sino-Japan Trade

		Sino-Japan trade
1945	End of World War II	
1949	Foundation of People's Republic of China	
1950	Korean War	-Ban of Trade with China
1959	Nagasaki Flag Incident	-China cancelled trade.
1972	Diplomatic Normalization	-First boom with Chinese trade
1978	Deng started opening-door and economic reform principle.	-China became amenable to accept foreign direct investment.
1985	China buys consumer goods	-Second China Development Boom
1989	Tian'anmen Incident	
1990	Total trade records 115 billions US\$. Deng's Speech in South China	-Big decrease of Japanese export to China
1992		
1994	The total trade records 281 billion	-The Japanese export to China
1995	US\$	became over 20 billion US\$.
1997	Asian Currency Crisis	
1998	Chinese Trade volume became no.5 <sup>th</sup>	
2000	in the world	
	Accession to WTO	
2001	The trade became no.4 <sup>th</sup> in the world.	
2002		-The two-way trade became over 100 billion US\$.
2004	The Chinese trade volume became no.3 in world trade.	

and partly on Japanese statistics. Accordingly we can see the whole picture of Chinese trade in relation to Sino-Japan trade.

## 2 . Period from 1945 to 1949

Sino-Japan Trade before World War II closely matched that of the US.

Immediately after the war, in China, conflicts for power and control of China occurred between the Kuomintang (Nationalist Party) of Chiang Kai-shek and the Communist Party of Mao Zedong. The civil war began in the North-East of China and prevailed down to the south. On October 1st 1949, the government of the People's Republic of China (PRC) declared the foundation of a "New China".

President Chiang Kai-shek flew to Taiwan from Chengdu, Sichuan province. At that time, trade between China and Japan was sluggish due to China's civil war. At the same time, the regime on the Chinese mainland changed from the Nationalist to the Communist Party. Japan chose to maintain the relationship with the Republic of China led by the nationalist party which controlled the island of Taiwan Island and a few other islands, as the legitimate government of all China instead of the PRC. This meant that the PRC, which controlled almost all of the China continent, was not recognized as a legally authentic government by western countries including Japan. Under this situation, Japanese trade with China was limited to that area of private trade channels. At the same time, the trade with the communist block was severely controlled by an international system of Co-com and Chin-com which prohibited many trade commodities with the communist block.

### 3. Period from 1949 to 1972

The total trade value between the two countries in 1950 was 47 million US\$. At the time of Korean War (1950-1953) the value was negligible due to prohibition of trade with China, which later joined the Korean War on the side of North Korea. Japan was obliged to import natural resources from nations other than China. For example, Japan began to import iron ore from Goa, India.

The level of the Sino-Japanese trade was about 400-800 million US\$ from mid-1960s to the late 1970s. In 1959, trade was suddenly suspended for about one year because the Chinese government made a protest against the Japanese government-saying the Japanese government did not take proper actions against a Japanese who insulted the national flag of PRC at a department store in Nagasaki city. However, the Chinese government re-opened trade with Japan the following year.

(see the chart 2: years 1959 & 1960)

The duration between 1949 and 1972 can be summarized as an age dominated by politics in Sino-Japan trade from the standpoint of Japan.

China took a hard-line policy with the Japanese companies which traded with Taiwan. So, many large Japanese companies could not trade with China. Only the companies that were recognized by the Chinese government and labeled "friendly trading firms" were permitted to trade.

So the trade between the two countries was carried out by limited groups who were in favor of the Chinese political line. The Chinese government made great use of those groups for the sake of its political means. However, this irregular situation in the trade arena came to end after diplomatic normalization of the two countries in 1972. The "friendly trading firm" concept gradually faded away, following this normalization.

The turning in trade between the two countries came when a worsening China-Soviet relations brought about a change in Chinese foreign policy in the early 1970s. China became willing to accept trading terms with the US, following a visit by President Richard Nixon in 1972. Soon after, the Japanese government took an initiative to normalize the two countries' diplomatic relations. Finally, in September 1972 the Japanese government gave full diplomatic recognition to PRC. At the same time, the Japanese government withdrew its recognition of the Nationalist government in Taiwan. The PRC and the Nationalist government changed places. The PRC became flexible to have understood the close economic relations between Japan and Taiwan. The PRC government accepted that Japan maintains non-governmental exchanges with Taiwan.

The following chart (Chart 1) shows Japan's major trade partners in the year 1971-72. The largest trade partner of Japan is the US in the both export and imports according to trade statistics. In 1972, China ranked 12th as a Japanese export partner, and 11th as an import partner. And the share of China is 2.1% for both exports and imports.

Chart 1 Japanese major trade partner in the year 1971-72

Unit: million US\$

	1971					1972				
World 100%	Export 24,019	Rate* 24.3	Import 19,712	Rate 4.4	Total 43,731	Export 28,591	Rate 19.0	Import 23,471	Rate 19.1	Total 52,062
US share	7,495 31.2	26.2	4,978 25.3	-10.5	12,473	8,848 30.9	18.0	5,852 24.9	17.6	14,700
China share	578 2.4	1.6	323 1.6	27.3	901	⑫ 609 2.1	5.3	⑪ 491 2.1	52.0	1,100
South Korea share	856 3.6	4.6	274 1.4	19.9	1,130	980 3.4	14.5	426 1.8	55.2	1,406
Taiwan share	923 3.8	31.8	286 1.5	14.1	1,209	1,091 3.8	18.1	422 1.8	47.5	1,513
Hong Kong share	787 3.3	12.4	98 0.5	6.8	885	910 3.2	15.5	119 0.5	21.7	1,029
Germany share	658 2.7	19.6	607 3.1	-1.6	1,265	930 3.3	41.3	681 2.9	12.2	1,611
Australia share	719 3.0	16.6	1,752 8.9	20.9	2,471	728 2.5	1.3	2,205 9.4	25.8	2,933

Source: summary of foreign trade of Japan in 1972

“Rate” refers to increase or decrease rate in comparison of previous year.

Major trade partners of Japan in 1972			
<Export>		<Import>	
①US	8,847	①US	5,852
②Canada	1,104	②Australia	2,205
③Taiwan	1,091	③Iran	1,490
④Liberia	1,021	④Indonesia	1,198
⑤Korea	980	⑤Canada	1,149
⑥England	979	⑥Saudi Arabia	901
⑦Germany	930	⑦Germany	681
⑧HongKong	909	⑧Soviet	594
⑨Australia	728	⑨Kuwait	548
⑩Singapore	702	⑩England	501
⑪Indonesia	615	⑪China	491
⑫China	608		

Source: summary of foreign trade of Japan in 1972

#### 4. Period from 1972 to 1992

##### 4.1 The trade under Chinese planned economy

The Japanese government and Business circles expected that trade would increase to a much higher level following the normalization because of China's enormous population, its geographic proximity and its market potential.

There was enormous potential to develop the market due to the low level of living standards of the Chinese population at large. At the time of diplomatic normalization, the first boom in the Chinese market began, and hopes that China would take a positive attitude to enhance the general level of its peoples living standards were high. However, this did not last for much longer than several months owing to a low level of Chinese foreign reserves. The Chinese trade authority explained that, "China has a big market, and the market is well controlled by a planned economy. If it needs certain products to buy, it buys them. If not, then it does not buy. As for exports, China sells if it has supplemental products under this planned economy."

The Chinese government had recognised that it must catch up with surrounding countries like Korea and Singapore. These nations had developed substantial economic power, while China struggled at the time of the Great Cultural revolution(1967-1976). Actually China had much to import, but not much to export.

The Japanese government helped China in many economic fields for the purpose of supporting the Chinese economy and promoting trade between the two countries. For example, the Chinese government decided to build an advanced technology such as steel factory in Shanghai with the co-operation of Japanese steel companies. However, during construction, the Chinese government found that they could not afford to continue the project due to a lack of funds. Finally, the Japanese government helped with special financing conditions in order to ensure that the project was completed.

The Japanese government made plans to import natural resources like petroleum and coal from China, and export capital goods to China from around 1978.

For Japan, which was heavily dependant on the Middle East for energy, it stove to diversify its sources of energy-including China. For China, it was convenient to have various capital goods without requiring cash from Japan. Projects to enhance two-way trade were positively encouraged by the Japanese side.

### **(1) Move to a market-oriented economy**

Following Deng Xiaoping's rise to power in the Chinese communist party in 1978, Chinese basic policy changed from sticking to a hard ideological line to showing the world that China was to be an authentic socialist country. Putting a strong emphasis on its economic construction-rather than on international politics, China came to recognize the importance of overseas development aid, and accepted the first official loans from Japan. Those loans from Japan were utilized to develop infrastructures like power station, telephone systems and so on, and in developing energy fields like coal and petroleum.

Since the founding the PRC in 1949, the Chinese have conducted external trade under a centralized system much in a manner of the Soviet Union-that is, through 12 major trading corporations, all under the jurisdiction of the Ministry of Foreign Trade. They had sole rights to trade with foreign countries. This meant that the traders and manufacturers were almost completely separated from each other. So all the traders could do, was get discounts from foreign trade partners when importing. At any rate, efficient trade could not be expected

Chart 2 China-Japan Trade

	Japan-China Trade(10 thousand US\$)			China Trade(Unit: 100 million US\$)			Balance
	Total value	Export	Import	Total value	Export	Import	
1950	4,719	2,105	2,614	11	6	6	-0.3
1951	1,290	95	1,195	20	8	12	-4
1952	440	332	108	19	8	11	-3
1953	992	680	312	24	10	14	-3
1954	3,517	2,057	1,460	24	12	13	-1
1955	8,331	5,817	2,514	31	14	17	-3
1956	12,840	6,474	6,366	32	17	16	1
1957	11,473	5,966	5,507	31	16	15	1
1958	8,065	3,252	4,813	39	20	19	1
1959				44	23	21	1
1960	19		19	38	19	20	-1
1961	3,609	2,164	1,445	29	15	15	0.4
1962	7,379	3,163	4,216	27	15	12	3
1963	12,926	6,482	6,444	29	17	13	4
1964	30,209	14,128	16,081	35	19	16	4
1965	45,426	19,243	26,183	43	22	20	2
1966	60,315	26,938	33,377	46	24	23	1
1967	53,793	23,366	30,427	42	21	20	1
1968	53,980	20,491	33,489	41	21	20	2
1969	58,256	20,080	38,176	40	22	18	4
1970	80,654	22,381	58,273	46	23	23	-1
1971	87,578	28,135	59,443	48	26	22	4
1972	103,917	41,178	62,739	63	34	29	6
1973	194,857	84,112	110,745	110	58	52	7
1974	312,526	114,255	198,271	146	70	76	-7
1975	379,548	140,300	239,248	148	73	75	-2
1976	303,952	122,291	181,661	134	69	66	3
1977	346,525	135,671	210,854	148	76	72	4
1978	482,380	171,865	310,515	206	98	109	-11
1979	670,814	276,413	394,401	293	137	157	-20
1980	920,115	403,224	516,891	381	181	200	-19
1981	997,803	459,715	538,088	440	220	220	
1982	876,091	486,077	390,014	416	223	193	30
1983	907,729	445,684	462,045	436	222	214	8
1984	1,392,158	541,786	850,372	536	261	274	-13
1985	2,114,430	610,897	1,503,533	696	274	423	-149
1986	1,721,792	477,945	1,243,847	739	309	429	-120
1987	1,647,248	639,828	1,007,420	827	394	432	-38
1988	1,894,546	790,231	1,104,315	1,028	475	553	-78
1989	1,892,862	839,468	1,053,394	1,117	525	591	-66
1990	1,659,900	901,103	758,797	1,154	621	534	87
1991	2,028,313	1,025,158	1,003,155	1,356	718	638	81
1992	2,536,117	1,167,871	1,368,246	1,655	849	806	44
1993	3,906,530	1,577,665	2,328,865	1,957	917	1,040	-122
1994	4,790,553	2,157,862	2,632,691	2,366	1,210	1,156	54
1995	5,747,122	2,846,669	2,900,453	2,809	1,488	1,321	167
1996	6,005,830	3,087,448	2,918,381	2,899	1,511	1,388	122
1997	6,083,340	3,183,858	2,899,482	3,252	1,828	1,424	404
1998	5,789,918	2,969,199	2,820,719	3,239	1,838	1,402	436
1999	6,616,726	3,239,901	3,376,825	3,606	1,949	1,657	292
2000	8,316,399	4,165,431	4,150,968	4,743	2,492	2,251	241
2001	8,772,783	4,494,052	4,278,731	5,097	2,661	2,436	225
2002	101,905,389	48,437,459	53,467,930	6,208	3,256	2,952	304
2003	133,573,395	59,422,570	74,150,825	8,510	4,382	4,128	255
2004	167,886,361	73,514,291	94,372,070	11,546	5,933	5,612	321

Source: Chinese customs statistic

under this separated trade system. However, the windows to trade were severely restricted until a more flexible system of trade was introduced in the 1990s.

In other words, in China there was an absolute idea of “trade rights” which was issued to those units trading with foreign countries by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). Following that time, the numbers of companies that had trade rights increased. The foreign companies which did not have these rights cannot conduct foreign trade. So the companies which do not have the rights are obliged to entrust export or import to those which have the rights. The system of trade rights is going to be terminated by 2004 because China promised to abandon it at the time of its accession to the WTO. The system ensured that they maintained strong bargaining powers with foreign countries.

Around this time, Guangzhou Trade Fairs were held both in spring and autumn. These large events did a great deal to stimulate trade with China.

In the wake of central government’s adoption of the ‘open-door principle’, forms of trade have diversified, as can be seen from the introduction of processing contracts, compensation trade and joint ventures —“a far cry from the traditional Chinese trade policy”.

The reforms in the trade system are regarded as part of China’s overall economic reform and their progress is closely linked to that of the general economic reforms as a whole. They constitute one of the main pillars for achieving the “four modernizations” called for at the third plenary session of the Communist Party’s Central Committee in late 1978, and are aimed primarily at improving outmoded aspects of the system through the application of the ‘open-door principle’ and decentralization. It is widely known that China makes it a basic policy to conduct trade with the rest of the world on the principles of independence and self-reliance, equality and reciprocity, and mutually complimentary relations. During the Cultural Revolution, the Chinese government declined to accept foreign credits, assistance, or investment and held tight reins on the introduction of foreign technology and the export of resources. However, it departed from this closed position in 1978 and has since been following a more realistic policy.

Processing contracts were first proposed by the Chinese during the Guangzhou Trade Fair in autumn of 1977. This marked the start of the diversification of the Chinese trade forms as well as the initiation of processing contracts with foreign business enterprises. Processing trade deals include formulas whereby the Chinese import materials, process them and export the finished products, process domestic materials according to specifications provided by foreign corporations, or carry out assembly. As for compensation trade, it was first reported in 1978 that China took a positive view of such trade.

## (2) China started to buy the egg

It was not until 1985 that the second China trade boom came to Japan. Chinese trade was characterized by the purchase of only capital goods instead of consumer goods. They say that we will buy the chicken and will not buy the egg. However China began to purchase “the egg” from this year. China bought quite a few colour TV sets, cars and so on. In China, there was inflationary pressure—namely a big demand and a small supply. There was a fear of

'demand-pull inflation'. So China began to buy these durable consumer goods mainly from Japan to narrow the gap. The government sold these commodities to the people at much higher prices than that of import and successfully absorbed the over-circulated money. Finally, China was able to control the inflationary situation-having made great use of this import situation. The boom did not continue long owing to its limited foreign reserves. According to the Japanese trade statistics, China ranks for the first time, the 2nd largest importer of Japanese goods and 6th largest exporter to Japan in 1985.

At that time, China had big complaints against Japan-saying that all Japan did, was sell to China and did not try to buy. They believed that Japan should help China export. The Japanese government decided to make the Japan-China association on economy to assist and promote Japanese imports from China. Hundreds of Chinese experts were invited to study world trade customs and to understand technical knowledge and know-how in order to expand Chinese overseas trade. Within a few years, the problem of the trade imbalance with Japan was solved. Chinese exports to Japan became bigger than that of imports in 1988 (according to Japanese trade statistics.).

### (3) Inflow of FDI into China promotes Chinese export

It was in 1973 when Chinese total trade recorded 10 billion US\$ for the first time. As for exports, in 1979, China attained over 10 billion US\$, as for import, it was in 1978 when this figure was reached. It can be said that Chinese trade has been fast to expand after Deng Xiaoping took power in 1978. And in line with the opening-door and economic reform principles, China got the chance to encourage Chinese trade. China restarted to accept foreign direct investment (FDI). Firstly China set up four "special economic zones (SEZ)", namely in Shenzhen, Zhuhai, and Shantou in Guangdong province, Xiamen(Amoy) in Fujian province. Later the Hainan island in Guangdong province was added as an SEZ. The investment law in China was gradually adopted in order to acquire FDI. In accordance with the increase of FDI, Chinese trade rapidly grew. Especially after 1992, foreign direct investment into China has substantially increased owing to the confirmation of the open-door principle.

Following the Plaza Agreement in New York in 1985, the Japanese Yen was highly appreciated from 220 to 180 Yen against 1 US\$ in just one half year. Japanese manufacturers had no choice but to move abroad and find suitable places to set up factories. Some Japanese companies transferred their manufacturing to China or ASEAN countries.

In 1988, the total trade value of China reached to 100 billions US\$ for the first time. One of the featuring points of the 1980's was that China's trade balance basically recorded a deficit. In the 90's, Chinese trade expanded far more rapidly than before owing to this big increase of acceptance of FDI.

In the nineties, China entered the top 10 trade countries in the world and outstripped other major trading countries like Italy and Canada.

It should be noted that China devalued its currency against the US\$ six times after the introduction of the open-door principle. Whenever it faced the risk of going into the red in its current account of international balance of payment, devaluation of its currency was taken



place. The last devaluation was in 1994. Since that year, China has enjoyed a trade account in the black in terms of its international balance of payments.

In 1997, the Asian currency crisis started from Thailand. The main reasons for Thailand's crisis was a sharp decrease of Thailand's exports, the occurrence of 'capital flight' from Thailand for the fear of currency depreciation. The crisis prevailed among other Asean economies. In that year, China enjoyed favourable exports in comparison to the previous year. In the following year, Chinese exports did not decrease, although all Asian countries including Japan suffered from a big drop in exports. This fact tells us that Chinese trade had strong competitive powers.

The characteristics of Chinese trade can be summarized as follows:

- A) Chinese trade developed quickly in a short period. The external trade expanded from 103 billions US\$ in 1988 to 621 billions US\$ in 2002. Now the Chinese economic size ranks 6th in the world and heads for a further high position. Such a rapid development of trade on such a huge scale had never been seen in the history of trade.
- B) The main reason of the development of the trade was the introduction of FDI. Now foreign companies in China supported half of Chinese exports. The trade structure was changed from a traditional style to capital intensive style. Main export and import items were electrical and electronics. China was said to be the factory of the world.
- C) The entry into WTO may help Chinese economy grow and contributes expansion of the trade.
- D) There is a high dependence in the Chinese economy on international trade. The trade dependence (trade volume/GDP) of China is more than 50%. This means that the Chinese economy is heavily dependent on its exports and imports. So the trade is one of the most important factors in economic growth.
- E) China has a plan to make its economic scale double in 10 years. China puts emphasis on the introduction of FDI in order to attain the target. So that the Chinese economy and trade continues to develop.
- F) One of the weakest points of China is R & D. The Chinese government has to invest in the R & D field so as to conquer this weak point of the Chinese economy.

#### (4) Synchronizing between Japanese FDI into China and import from China

First, Chinese trade dependence on Japan is 16.5% in 1972, 22.6% in 1980, 14.3% in 1990, 16.4% in 2002 respectively. China's largest trading partner is Japan in many years. From the statistics in 2002, Japan ranks no. 3 as an export partner after the US and Hong Kong. As for its import, Japan ranks no. 1.

From 1988, Japanese trade with China continues to be in deficit until now. This means that Chinese commodities became internationally competitive due to getting FDI.

In the year 1990, Japanese exports to China decreased dramatically, because in China in June of the previous year, the "Tian'anmen square incident" in Beijing occurred. The Japanese export figure to China declined to about half as much as the level of 1985. This kind of an incident shows clearly that China stops judging over import, once China falls in

Chart 3 The trend of Japanese trade with China

Unit : million US\$

Year	Export	Rate(%)	Import	Rate(%)	Total	Rate(%)	Balance
1972	609	5.4	491	52.0	1,100	22.1	118
1973	1,039	70.6	974	98.4	2,013	83.0	65
1985	12,477	72.9	6,483	8.8	18,960	43.9	5,995
1986	9,856	-21.0	5,652	-12.8	15,509	-18.2	4,204
1987	8,250	-16.3	7,401	30.9	15,651	0.9	848
1988	9,476	14.9	9,859	33.2	19,335	23.5	-383
1989	8,516	-10.1	11,146	13.1	19,662	1.7	-2,630
1990	6,130	-28.0	12,054	8.1	18,183	-7.5	-5,923
1991	8,593	40.2	14,216	17.9	22,809	25.4	-5,623
1992	11,949	39.1	16,953	19.3	28,902	26.7	-5,004
1993	17,723	44.6	20,565	21.3	37,838	30.9	-3,292
1994	18,680	8.1	27,565	34	46,245	22.2	-8,884
1995	21,930	17.4	35,922	30.3	57,852	25.1	-13,992
1996	21,891	-0.2	40,536	12.8	62,427	7.9	-18,645
1997	21,782	-0.5	42,041	3.7	63,823	2.2	-20,259
1998	20,098	-7.7	36,893	-12.3	56,916	-10.7	-16,795
1999	23,329	16.5	42,850	16.1	66,179	16.3	-19,521
2000	30,438	30.4	55,341	29.1	85,780	29.5	-24,902
2001	31,097	4.0	58,099	5.1	89,196	4.0	-27,020
2002	39,867	28.2	61,670	6.1	101,537	13.8	-27,014
2003	57,219	43.5	75,193	21.9	132,412	30.4	-17,974
2004	73,833	29.0	94,215	25.3	168,048	26.9	-20,382

Source: the ministry of finance of Japan

unstable conditions. On one hand, Chinese export to Japan continues to increase, since Japanese investment into China has increased. Especially after 1992, it became clear that China does not change its open-door principle which is started and confirmed by Deng Xiaoping. He insisted on acceleration of the opening-door and all-directions of decentralization. Until then the opened area for foreign companies was limited to a coastal region in the West, but Deng asserted that the opened regions should be enlarged not only along the east coast, but also along the Changjiang river, and along the border of Chinese territory. At the same time, the line of business should be expanded to service fields like banking, retailing and so on. Laws related to foreign investment are now well formed in the 15 years after 1978. And infrastructures like roads, harbour facilities et-cetera are gradually improved. So foreign companies including those from Japan, rushed to China to invest in those various fields. Japanese investment into China on actual basis attained the level of 1 billion US\$ from 1993. (see chart 4)

As for the investment purpose of a foreign company for China, there are three types; one is export-oriented that a foreign company sets up a factory in China and processes commodities and exports them abroad. This type of investment is strongly recommended by the Chinese government, because China can get foreign capital, more employment, and introduc-

tion of various technologies. The second type is a market-oriented investment which was rare in the early 1990s, because the Chinese government took a hard line policy toward foreign companies directly selling those commodities in the Chinese market. The third type is a mix of export and market-oriented.

In China, the authority classifies the types of investment into three. One is called the contractual joint venture. Second is the cooperative joint venture. Third is 100% investment by a foreign company. In the early 1990s, the Chinese authorities recommended foreign companies establish contractual joint ventures. A foreign company had a handicap for selling their commodities processed in China owing to restrictions by Chinese law if it intends to sell their commodities in Chinese market owing to strict control by Chinese restrictions. However, later the Chinese government did not stick to this policy. In recent years, a Japanese company has a tendency to set up 100% of investment. In case of establishing a joint venture, it is convenient to sell domestically, but it is troublesome to carry out the company due to differences of opinions in management.

If we examine the trend of Japanese direct investment in China, the category started from light industry that requires intensive labour (like the textile industry). There are many items that belong to Japanese tradition which require high labour intensity like "obi", "shishuu" (Japanese traditional belts and embroidery for "Kimonos"). It is difficult to find Japanese workers for the carvings for a Buddhist altar in Japan. Those labour-intensive products were beginning to be made in China. If not, those traditional techniques in Japan might have faded away. In accordance with enhancement of the Japanese economy, most labour-intensive industries were transferred to China. If the trade stopped suddenly, these labour-intensive items cannot be found in the Japanese market.

We can see a transition from low-value product manufacturing to high quality of Chinese export commodity by examining textile items. Twenty years ago, we could find Chinese made underwear in the basement of a super-market (a bargain basement). A commodity "made in China" meant a cheap item. The brand of "made in China" can be recognized only when one try to carefully seek it. About 15 years ago, shirts "made in China" became more popular than underwear among ordinary people due to its low prices. Then, suits became popular for salary men. Of course, high quality wear for women was partly produced in China for the Japanese market. But now, in recent years, those made in China textile items are famous Japanese brand names like UniQlo-and they have become very popular among the young generation for its price and quality. Now we see that Chinese products have come to have strong competitive powers in terms of both price and quality.

In recent years, electronic items started to be substantially imported from China. Colour TV sets imported from China are counted as major commodities amongst other items.

In 1995, Chinese authorities announced the collection of a retrospective value-added tax for 1994. The tax authority at the beginning explained that this tax for export items is refunded 100% after collection within a certain period. However, after half year, the authority modified to refund half of the tax collected, not all the tax as promised.

Because injustice in trade field was done by Chinese companies. For example, those com-

Chart 4 Japanese FDI into China

Unit: million US\$

Year	Contract basis				Actual basis	
	Value	Rate	Numbers	Rate	Value	Rate
1990	457	51.8	341	16.0	503	41.3
1991	812	77.7	599	75.7	533	6.0
1992	2,173	67.6	1,805	301.3	710	33.2
1993	2,960	36.2	3,488	93.2	1,324	86.5
1994	4,440	50.0	3,018	-13.5	2,075	57.1
1995	7,592	70.7	2,946	-2.8	3,108	49.5
1996	5,131	-32.4	1,742	-40.9	3,679	18.3
1997	3,401	-33.7	1,402	-19.5	4,326	17.7
1998	2,699	-20.7	1,188	-15.3	3,158	-27
1999	2,490	-7.8	1,136	-4.4	3,000	-4.9
2000	3,681	5.9	1,614	7.2	2,916	-7.2
Total	38,700		20,383		27,800	
2001	5,420	47.2	2,019	25.1	4,348	49.1
2002	5,298	-2.3	2,745	-29.9	4,190	-3.6
2003	7,960	50.2	3,254	18.5	5,050	20.6
2004	9,160	15.0	3,454	6.1	5,450	7.9

Source : MOFTEC, Ministry of Commerce

panies which did not conduct a trade, got refunded through fraud papers. So the tax authority faced shortage of resources paying more and getting less. The value-added tax issue became the top hot problem amongst trading circles. In 1998, the problem of the tax was settled in a manner of refunding all the tax concerning almost all export items.

In November 2001, China was admitted to be a member of WTO. The Chinese government promised many things when entering WTO, including :

- a) To make implementation of law transparent
- b) Lowering custom duties
- c) Abolition of import restrictions
- e) Releasing restraints for service areas
- f) Abolition of various subsidies

It is important for China to keep those promises so that China gets more credit and FDI from the rest of the world.

##### (5) Sino-Japanese trade in 2002

The Japanese two-way trade with China in 2002 recorded 101.5 billion US\$, up 13.8% in comparison with the previous year. This figure is the biggest in Sino-Japanese trade history. The share of Chinese trade in terms of the Japanese total trade grew from 11.8% in 2001 to 13.5% in 2002. China is the second largest trade partner of Japan after the US.

Japanese export value to China grew 28.2% compared with that of 2001. The value was 39.8 billion US\$. China became the no. 2 export partner of Japan in 2001. The share of China grew from 7.7% to 9.6% in 2002. The share of the US is 28.5%, Korea 6.9%, Taiwan 6.3%.

Amongst Japanese export items to China, the commodities which showed big increase were electronic parts like ICs, cars, steel, metal processing machineries.

The main factors of export increase are as follows.

- A) A demand for the goods which are hard to procure in China but available from Japanese factories has substantially increased.
- B) A demand for capital goods from Japanese companies in China has also swelled.
- C) Public demand of the Chinese government has increased.
- D) Import tax rates are decreased due to promises at WTO.

China became the largest source of Japanese imports for the first time in 2002. The value of Japanese imports from China was 61.7 billion US\$, 6.1% up as compared with previous year. The share of China improved 18.3%, while that of the US shrank to 17.1% in 2002. The share of Korea is 4.6%, Indonesia is 4.2%.

Amongst items imported from China, textiles had the largest share, but machinery became the top in 2002. The Chinese share of the textile products market in Japan occupy 71.9% in 2002 (70.7% in 2001). Japanese dependence on Chinese textile products increases year by year, although Chinese textile export to Japan decreased by 6.5% in 2002. Main reason of textile drop is a dull Japanese market, especially speciality store retailers of private label apparel-who imported less than the previous year. PC related products, copy machines, office machines etc are massively imported to Japan.

As for the trade balance with China, Japan has the largest 'red' in many years. The value is 21.8 billion US\$ in 2002.

#### (6) Sino-Japanese trade in 2004

The following is the press release by JETRO

##### **Japan's Trade with China Sets Sixth Straight Record in 2004**

February 21, 2005

Japan's trade with China in 2004 surged by 26.9% year-on-year to US\$168 billion, setting a new record for the sixth year in a row, according to a report released today by the Japan External Trade Organization (JETRO). Both imports and exports soared to new levels, suggesting the current upswing in trade will continue.

##### **1. Japanese exports of parts and materials to China remained buoyant, while exports of construction machinery and autos slipped**

Japanese exports to China rose for the sixth straight year in 2004, surging 29.0% year on year to US\$73.83 billion. This rise was fueled by an increase in exports of parts and materials that Japanese manufacturers operating in China have difficulty sourcing locally, including: semiconductors & other electronic parts (up 12.2%), semi-finished components for audio-visuals (up 15.4%), LCD & other scientific/optical devices (up 44.6%), auto parts (up 33.1%), steel materials for auto & home electric appliances (up 31.7%) and chemical products (up 38.5%). There was also a significant rise in exports of industrial machinery, such as metal working machinery (up 68.2%) and centrifugal pumps (up 41.1%). Exports of construction machinery, telecommunication equipment and autos, however,

fell by 14.8%, 45.7% and 14.2%, respectively.

## **2. Japanese imports of finished products from China soared, reflecting the continued expansion of Japanese production bases in China**

Japanese imports from China in 2004 increased 25.3% year-on-year to US\$94.21 billion (the sixth straight rise in as many years), as Japanese companies continued to shift production operations to China. Sharp increases were noted in finished products, such as personal computers, printers & other office equipment (up 31.2%), DVD players & other audio-visual equipment (up 32.8%), and mobile phones & other telecommunication equipment (up 58.2%). Imports of components, mainly for general purpose equipment, also surged, most notably in semiconductors & other electronic parts (up 82.1%) and LCD & other scientific/optical devices (up 26.3%). Imports of textile products (which accounted for roughly 20% of total imports from China) and foodstuffs rose a steady 13.1% and 21.5%, respectively.

## **3. Japan-China trade reached a near balance in 2004 (in real terms)**

Although Japan's trade deficit with China rose US\$2.48 billion in 2004 to reach US\$20.38 billion, Japan's trade balance (in real terms) with China has been shrinking since China's ascension to WTO at the end of 2001, if trade via Hong Kong is taken into account. In 2004, this real term trade balance was close to even.

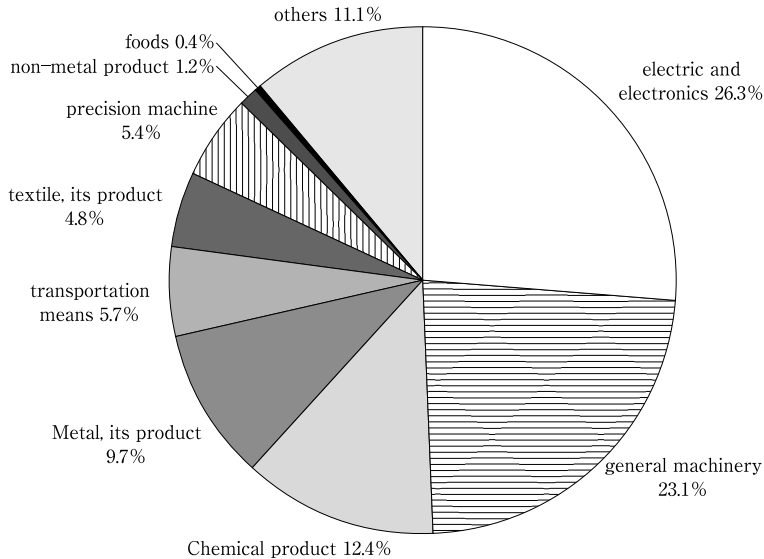
## **4. Japan's trade with China in 2005 is expected to exceed the US\$190 billion mark, setting yet another record**

Despite some remaining uncertainty over Japanese exports to China, due to a slowing in global demand for personal computers and home electric appliances-as well as a lingering inventory adjustment process in consumer durable goods-Japan's overall trade with China (including imports and exports) is likely to exceed the US\$190 billion mark in 2005, setting a record for the seventh straight year. Japanese exports to China of finished products for China's domestic market and semi-finished components for Japanese manufacturers operating in China are expected to show steady growth in 2005. Japanese imports of finished products from China are also expected to grow considerably in 2005, as Japanese companies continue to shift production operations to China.

\*Figures are based on dollar conversions of yen-denominated statistics released by the Japan Ministry of Finance.

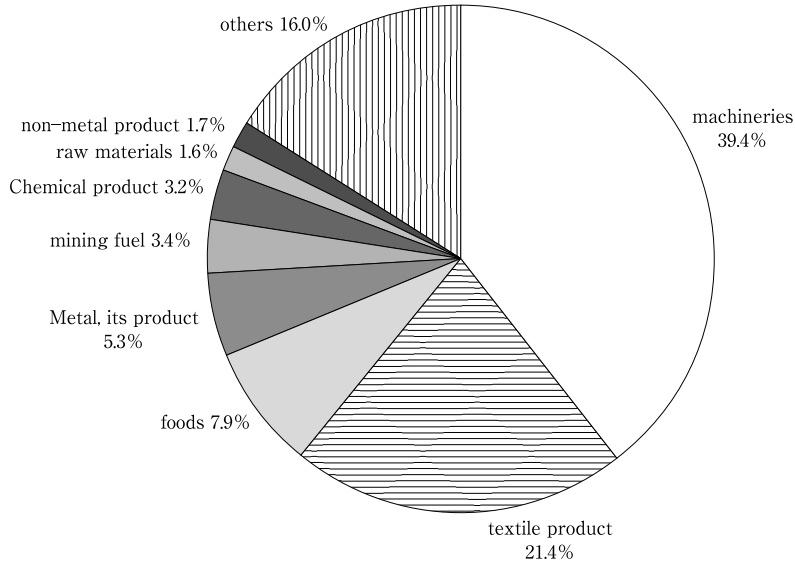
Sino-Japanese trade in recent years has become one of the most important elements for both countries. From the standpoint of China, Japan was the no.1 trading partner for the two-way trade for many years. But from 2004, the US became no.1 trade partner of China. As for the export partner, Japan is no.3 after the US and Hong Kong. As for the import partner, Japan is no.1. For China, Japan is the most convenient industrialized country that

Chart 5  
Japanese export items to China in 2004



source : the ministry of finance of Japan

Japanese import items from China in 2004



source : the same as above

can meet the needs of China at any suitable time. China has utilized economic powers of Japan for the sake of its modernization through trade and technical assistance and so on.

The year of 2004 in Chinese trade history after the World War II became epoch making one. Firstly, Total trade volume of China surpassed that of Japan and became no. 3 after the US and Germany for the first time and is expected to accelerate its growth rate years to come owing to its potentiality. Secondly, from the standpoint of China, the US became the

largest trade partner in the place of Japan. On this score, trade imbalance between the US and China widens year by year in favour of China. According to the statistics by the US Department of Commerce, 124 billion US\$ deficit is recorded for the trade with China standing no. 1 from 2000, while the US deficit with Japan's trade is 66 billion US\$ in 2004. Thirdly, Chinese trade dependence ratio became highest; 69% (Japan's trade dependence rate is 20%). This means that Chinese economy is vitally involved to that of the world, mainly dependent on the developed countries. China has to expand its trade volume in order to have high growth of economy. In this sense, China, for the time being, has no means but to basically stick to the present exchange rate of RMB against US\$, although on 21st of July the People's Bank of China announced to have a flexible control over the exchange rate of RMB. Fourthly, China enjoys large trade surplus in recent years over the range from 20 billion US\$ to 30 billion US\$.

Chinese government now makes the 11<sup>th</sup> Five Years Economic Development Programme starting from 2006 to 2010. Amongst its programme, a new target of an average yearly growth rate of GDP is set to be over 9% instead of 7%. It implies that China has to enlarge its trade more than before, unless China changes a present trade dependent structure of economy into that of domestic market.

From the standpoint of Japan, the total trade with China had a small portion at the time of diplomatic normalization in 1972, the share of Chinese export and import in Japanese market occupy only 2.1% respectively. The ratio of Chinese trade in the whole trade of Japan, China was 1/8 in 1972, 1/4 in 1985, and 1/3 in 2004. Chinese trade expands far faster than the growth of the economy. Through mutual cooperation, the Chinese economy became one of the major powers, namely no. 6 in the world economy from 2001. The scale of Chinese trade became no. 4 in 2002 and no. 3 in 2004.

As a total trade, China stands no. 2 after the US. China as an import partner became no. 1 in 2002 for the first time outstripping the US. As an export partner, China ranks no. 2. When it comes to trade balance between the two countries, it continues to be favourable for China from 1988. The Japanese trade deficit with China is no. 1 for more than 10 years, and has a tendency to become larger and larger. As a reference, the second largest 'red' for Japan is Indonesia or Saudi Arabia due to the import of petroleum. Import from China benefits Japan in many ways. It helps Japan make a higher economic structure. For example, versatile items like an ordinary colour TV are imported from China with reasonable prices. Japan concentrates to make more sophisticated TV for the high-class market. In the Japanese market, there are varieties of TV from low to high end commodities. And Japanese traditional goods continue to be manufactured in China.

The trade between Japan and China is so dependent on each other that it is inseparable at present. The trade relations of the two countries at the time of diplomatic normalization in 1972, the trade manner was "vertical" which means Japan exports capital goods to China, and China exports raw materials to Japan. The trade character is called that of 'a developed and a developing country'. In recent years, this relation between the two countries has changed to be "horizontal" which means Japan and China export capital goods each other.



Chart 6 The comparison of trade volume between China and Japan

Unit: billions of US\$

	Total		Export		Import	
	China	Japan	China	Japan	China	Japan
1972	6.544	52.951	3.693	29.088	2.851	23.863
1985	69.602	307.652	27.350	177.164	42.252	130.488
2001	510.141	752.585	266.620	403.496	243.521	349.089
2004	1,154.80	1,019.457	593.400	565.150	561.40	454.307

Source: Original figures are from the International Financial Statistics Yearbook 2002. IMF and JETRO statistics

Chart 7 China's Major Trade Partners in 2004

Unit: million US\$, %

	total trade	increase	export	increase	import	increase	balance
	1,154,792	35.7	593,369	35.4	561,423	36.5	31,946
Asia	605,027	34.27	295,500	32.8	362,527	35.4	-67,027
Japan	② 167,006	25.7	③ 73,514	23.7	① 94,372	27.3	-20,858
Hong Kong	③ 112,678	28.9	② 100,878	32.3	11,800	6.1	☆ 89,078
Korea	④ 90,068	42.5	④ 27,818	38.4	③ 62,250	44.3	○ 34,432
Taiwan	⑤ 78,323	34.2	13,545	50.47	② 64,779	31.2	○ 51,234
Singapore	26,684	37.9	12,687	43.1	13,997	33.5	-1,310
Malaysia	26,261	30.5	8,087	31.7	⑤ 18,174	29.9	-10,087
Indonesia	13,481	31.8	6,257	39.6	7,224	25.7	-967
Thailand	17,343	37	5,801	51.6	11,542	30.8	-5,741
Africa	29,462	58.9	13,816	35.7	15,646	87.2	-1,830
Europe	211,443	33.9	122,402	38.8	89,041	27.8	33,361
Germany	54,124	29.7	23,756	36.2	30,368	25	-6,612
U.K.	19,729	37.1	14,968	38.3	4,761	33.3	10,207
France	17,585	31.3	9,922	36	7,663	25.7	2,259
Holland	21,489	39.2	⑤ 18,519	37.2	2,969	53.6	15,550
Italy	15,676	33.6	9,225	38.7	6,451	27	2,774
Russia	21,232	34.7	9,102	51	12,129	24.7	-3,027
Latin America	40,027	49.3	18,242	53.6	21,785	45.9	-3,543
Brazil	12,359	54.8	3,675	71.5	8,684	48.6	-5,009
North America	185,290	35.8	133,237	35	52,053	36	81,184
U.S.	① 169,626	34.3	① 124,948	35.1	44,679	31.9	☆ 80,269
Canada	15,516	55.1	8,162	44.9	7,354	68.1	808
Oceania	23,504	47.9	10,171	39.5	13,334	55	-3,163

Source: China Customs Statistics

Chart 8 The comparison of the economic scale between China and Japan

Unit: billions of US\$

	China	(rank)	Japan	(rank)
1985	391.1		1,487.2	
2001	1,131.2	6	4,523.3	2
2003	1,416.8	6	4,360.8	2

Source: world tables 1994, 2003 and 2005 world development indicators. The World Bank

The trend of trade has still much room to grow, mainly because of the development of the Chinese economy. The Chinese government decided at the 16<sup>th</sup> communist party congress in Autumn 2002 that the Chinese economy in 2020 should become 4 times as much as the economic scale of 2000. This means the Chinese economy in 2020 is equivalent to the size of present Japan. In order to attain this goal, China has to keep an annual economic growth rate of more than 7%. China has decided to hold the Olympic Games in Beijing in 2008, and the World Exposition in Shanghai in 2010. Japanese investment to China has the motivation to improve under this circumstance. Accordingly, the two-way trade has ground to further expansion.

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