

Foundation for Sino-Japanese Economic & Trade Relations

Mutual Benefit & Regional Cooperation

By WANG Yizhi

After adopting the reform and opening-up policy, China's economy has been linked much closer with the global economy, which stimulates the continuous economic growth. Among China's overall economic and trade relations, the Sino-Japanese economic and trade relationship is one of the most important ones for China and, considering the scale of bilateral trade, it is also significant for Japan.

Due to structural adjustment and other factors, the Japanese economy has been unable to get rid of "stagnancy in growth" in the recent decade, which causes a different development tendency from China's. Furthermore, the global financial crisis has aroused trade protectionism in Japan. Unsurprisingly the conflict of trade liberalization and protectionism has been always running through the development of the practice of international trade. How then should we think about the development of Sino-Japanese economic and trade relations from an objective and positive view?

1. Sino-Japanese Economic/Trade Development Highlights International Division of Labor Based on Comparative Advantage

During the mid-1980s, the yen appreciated under pressure from the G6 in Europe and the United States, followed by the appreciation of the South Korean won and the Taiwan dollar. Given the comparative advantage of land and labor costs as well as the huge potential market in China, the industrial capital of Japan and Asia's Four Little Dragons started to flow into mainland China in order to reduce costs and maintain their export competitiveness. Household appliances, clothing, toys and other labor-intensive industries were the main areas of investment. The industrial capital flow from Japan enlarged both China's imports of intermediate goods and capital goods from Japan and its exports of manufactured goods, promoting the growth of Sino-Japanese trade as a result.

Along with the deepening of China's reform and opening-up, the Yangtze River Delta, especially Shanghai's Pudong area, was driven to open up with better infrastructure and complementary industry conditions, attracting more direct investment from Europe and North America. International investment has gradually expanded to industries with higher composition of capital and technology such as automotive and ICT. After China's entry into the WTO in 2001, the country's export-oriented growth mechanism came into shape.

The development of economic and trade relations between China and other countries, just like relations between China and Japan, is mainly based on the comparative advantage of international division of labor. In fact, with foreign direct investment (FDI) pouring into China and sustained economic growth continuing, land and labor costs in coastal areas kept rising. Around 2005, Japanese companies began to shift their focus of overseas investment to Southeast Asia, which could be basically reflected in the data of Japan's direct invest-

ment and trade volume with China. Increasingly closer Sino-Japanese economic and trade relations have brought more opportunities for the companies both in China and Japan, which eventually contributed a lot to the rise of China's economy.

2. China's Terms of Trade Not Substantially Improve with Growth of Trade

After 30 years of sustained economic growth, China's scale of merchandise trade has become ranked third in the world, among which export trade ranks second globally. Together with the rapid growth of trade in scale, the trade structure also improved to a certain degree. For example, owing to FDI and multinational enterprises' outsourcing strategy of non-core businesses, China's exports of products in the SITC 7 category (machinery and transport equipment) have developed fast, which is reflected in the change of China's export structure to Japan (Charts 1-a/b).

According to United Nations statistics on world trade, China's exports to Japan mostly belong to SITC 7 and SITC 8, while trade growth was achieved mainly in SITC 7. Most Sino-Japanese trade is inter-industry trade. On the contrary, intra-industry trade between the two countries takes up only a small portion of trade despite rapid growth, which is in accordance with the theory that intra-industry trade mostly happens between developed countries. This article tries to analyze the Sino-Japanese trade structure from the perspective of trade in SITC 7.

CHART 1-a

Export structure from China to Japan

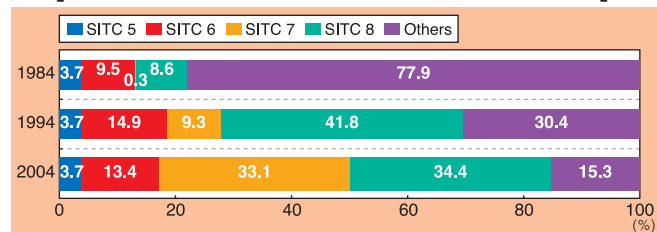
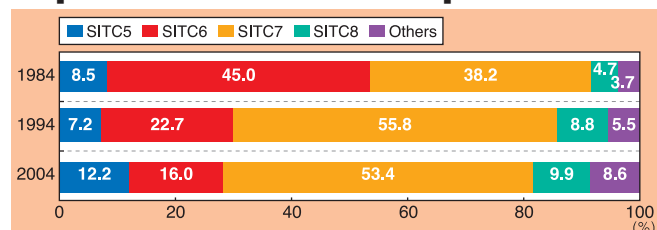


CHART 1-b

Export structure from Japan to China



Note: The primary product categories SITC 0 – SITC 4 as well as unclassified materials SITC 9 are categorized as "others" in this article.

Source: "A Study on the Sino-Japanese Economic and Trade Relations," SASS Working Paper (2007), by Wang Yizhi, etc.

TABLE

China's inter-industry trade volume of SITC 7 products with Japan (2005, \$1 million)

Production process	Low technology		Medium technology		High technology	
	Imports	Exports	Imports	Exports	Imports	Exports
Primary products	16.54	0	0	0	0	0
Parts & components	39.18	10.60	3970.65	749.37	6375.33	642.54
Final products	105.35	919.24	15358.46	1913.98	785.90	8899.58
Consumer products	1.27	525.16	1557.19	1421.70	24.52	1217.69
Capital products	104.08	394.08	13801.27	492.28	761.38	7681.89
Others	0.49	58.33	0	0	0.05	0
Total	161.57	988.17	19329.11	2663.35	7161.28	9542.12

Source: Calculated from data in UN World Trade Statistics database

China's major imports from Japan are medium-technology capital goods and parts (including medium-tech and high-tech) mainly consisting of machinery and electronic intermediate products related to R&D such as thermionic tubes, transistors, integrated circuits, liquid crystal panels, etc., where China sees a deficit in the balance of bilateral trade. On the other hand, China's exports to Japan are mainly final products including consumer goods and capital goods such as assembled computers and peripheral equipment, where China enjoys a surplus over Japan (Table). To some extent, this structure reflects the fact that Japanese enterprises didn't transfer medium-level production technology for key components to those in China, including China-based Japanese enterprises, while Chinese domestic enterprises still stay in the "processing and manufacturing" phase of international labor division in technology-intensive industries with low technology and added value.

The Sino-Japanese trade structure demonstrates China's role in the current division of labor in global trade: although the scale of China's merchandise trade has developed rapidly, the terms of trade have not substantially improved. It indicates in many cases that Chinese enterprises take up a quite small share of the overall profit of international labor division. According to the *World Bank Development Report*, China's GNI per capita in 2007 was \$2,360, remaining at the average level of low- and middle-income countries; even measured by per capita GNI at purchasing power parity (PPP) collected from World Bank data, Japan is still 6.5 times higher than China. Therefore, as a developing country with middle income, China is being demanded to take too much responsibility (such as the continuous appreciation of its RMB currency) in the international trading system.

With the rise of factor prices in China's coastal areas and the sustainable development strategy as well as the improvement in environmental protection and social security of employment, China's export-oriented growth mode is facing a great challenge, as seen in a drop in the proportion of merchandise trade to GDP from 66% in 2006 to 59% in 2008.

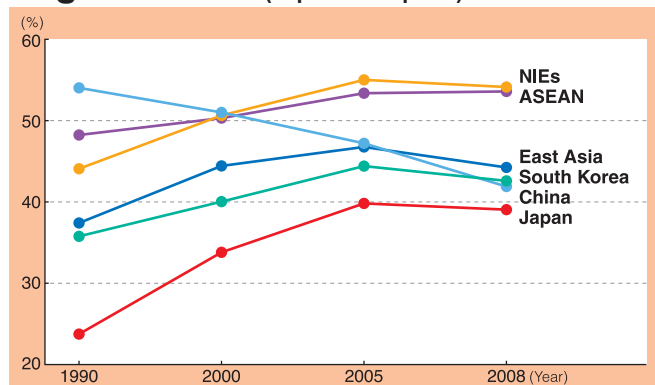
3. Global Financial Crisis: Opportunity for Promoting Economic Cooperation in East Asia

In 2008, the global financial crisis, triggered by the subprime loan mess in the United States, weakened the status of the US dollar as the international reserve currency. It is inevitable to establish a global reserve system for global financial reform to disperse the risks effectively. However, this reform is difficult to complete in the short term. During this reform, it may be a more realistic option to strengthen regional financial and economic cooperation when facing the current situation. Recently, this trend has been demonstrated by the exploration of the establishment of cooperation mechanisms by the central banks of China, Japan and South Korea.

East Asia has become an important source in the world economy. In the global economic downturn, it has become more important to

CHART 2

Ratios of intra-Asian trade volume to global total (imports & exports)



Source: Calculated from data in UN World Trade Statistics database

promote regional investment and trade, especially given the situation that trade protectionism in developed countries tends to rise. In fact, over the past 20 years, intraregional trade in East Asia has shown a remarkable upward trend (Chart 2). The expansion of ASEAN member countries and the promotion of the "10+3" cooperation framework, as well as the concept of establishing an East Asian Community proposed by Japanese Prime Minister Yukio Hatoyama, reflects the aspiration to strengthen regional cooperation.

There now exist many ideas to promote regional cooperation. However, they will face a large number of specific issues and coordination of interests when substantially propelling cooperation. With the current financial crisis widely considered to have touched bottom while the outlook for economic recovery is versatile, the majority view is that the recovery will be a long process. However, it provides a good chance for all the parties to gain a deep insight into the benefits of regional cooperation. From this perspective, it might be the opportunity to substantially promote economic cooperation in East Asia in order to get rid of the negative impact brought on by the financial crisis.

China and Japan are both the most important countries in East Asia, not only because of the scale of their economies and trade, but also because China and Japan have sufficient foreign exchange reserves, with the yen already an international currency and the RMB on the way to be freely convertible in the region. All these factors are vital to establishing East Asian economic integration. Therefore, it is very important for China and Japan to promote regional economic cooperation in East Asia, which is based on a stable Sino-Japanese economic and trade relationship and mutual political trust. **JS**

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