



The Reality of 2013 China-Japan Trade

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Trade statistics released in April of Japan by JETRO (*Japan External Trade Organization*) for April'13- March '14 have shown that China-Japan bilateral trade has decreased from \$334 Billion in 2012 to about \$312 Billion in 2013. This has led to some fears that the economic integration between the world's second- and third-largest economies is finally starting to break down. China-Japan bilateral relations have been subject to much curiosity for despite their hostile political relations, they have extensive economic engagement with their merchandise trade being the third largest in the world. The Senkaku/Diaoyu Island dispute has been followed by reducing Japanese imports in China as well as Japan shifting its FDI to South East Asia whilst decreasing the new investments in China. Yet if one looks more closely, the \$22 Billion decline in trade in 2013 can be attributed more so to structural shifts in the economies rather than their declining political relations. One can also not conclude that economics would play a lesser role from now on in the conduct of their bilateral affairs. Infact, economics and economic integration is likely to continue to play a very significant role with China and Japan having very limited policy interface of doing anything to lessen it.

Japan's Exports and Imports from China 2013 (adapted from JETRO)

Year	Exports (in US \$ Billions)	Imports(in US \$ Billions)	Total Trade	Change from previous year (in US \$ Billions)
2011	167.47	183.48	350.95	+49.05
2012	144.69	189.02	333.71	-17.24
2013	129.85	182.19	312.04	-21.67

Chinese Economy is clearly slowing despite posting the highest GDP growth rates in the world. High-Profile Trust defaults in early January this year in China have brought to notice its spiraling out of hand Shadow Banking sector that extends to about 70% of its GDP. Its Economic Model that emphasized heavy exports & investments is now proving to be challenging in view of the changing scenario. China has a live example of stimulus generated growth in Japan whose national debt today is huge, after years of spending on highways, bridges and other large-scale projects that were part of its previous stimulus packages, thereby sharply limiting the ability of the Japanese government to spend now . Should China continue to pump in stimulus money into the economy, not only would it add to existing problems of overcapacity and heating up the economy but would also encourage risky lending, pushing the country closer to a debt crisis. It can neither dry up liquidity nor default on payments that would erode the credibility of its growth nor risk inflation at a time when its rising labor costs have led to industries shifting out of China to nearby countries. How sound the Chinese fundamentals are may be disputed. Maybe there is no storm looming on the horizon, as many economists underscore China's economy to suffer. However what is definitely true is that China has structurally changed from its closed economy to an open, liberalized economy that has seen a very real and credible growth with huge foreign investments pouring in.

China's Annual Trade (adapted from Ministry of Commerce, People's Republic of China)

Year	Total Trade (in US \$ Billions)	Percentage change from previous year
2010	2972.76	+34.7
2011	3642.06	+22.5
2012	3866.76	+6.2
2013	4160.33	+7.6

Not only has it become the world's factory, it has also become the largest reservoir of forex reserves in the world. China is even the most preferred destination for hot money today. However today, it faces numerous tough questions. Though immense growth has occurred, it has been uneven. Prosperity has led to a better lifestyle for its masses; but it has also raised income expectations. And disregarding the financial mismanagement in favor of rapid growth has brought it on the brink of a probable economic disaster. To add to all that, China faces its worst adversary on its own territory- its deteriorating natural environment. So it has to re-evaluate whether or not to continue with the very policies that brought it out from the quagmire of famines and poverty to becoming a stronghold in international economy and politics. Japan too faced similar challenges decades earlier when it had to come to terms with it having crossed over from an industrial to a post-industrial state. It shifted out its industries to nearby China and South-East Asia to utilize the abundant supply of cheap labor and the vibrant economic policies of those states in late 1980s. Continuing with an FDI based model of growth while keeping the key technologies back at home is turning to be the only pragmatic choice in view of its rapidly declining and aging population.

About 83% of Japanese Exports worldwide comprise of high-tech goods with transport equipments (23%), heavy machinery (19%), electrical machinery (17%), chemicals (11%) and manufactured goods (13%) forming the major share¹. The decline in Japanese Exports to China can be seen to be consistent with the slowing down of industrial production in China. Also

¹ <http://www.tradingeconomics.com/japan/indicators>

Chinese government efforts to rein in the Real Estate bubble and changing consumer demands for example increasing preference for low-cost tablets/ smartphones that lowered Japanese expensive imports of semiconductors have pushed Japanese exports further down. Completion of investment cycles for Japanese firms that begun direct investments in early 2000s has led to a continuous 10% decrease in Japanese exports to China in both 2012 and 2013 with drastic decline in categories of general machines such as metalworking machines, construction and mining machines and electrical equipment such as semiconductors. Though a continued decrease in Japanese exports of automobiles and automobile components can partially be attributed to the anti-Japanese demonstrations in China, policies by Chinese government to initiate a quota on sales of vehicles and encourage development of domestic hybrid vehicles has been a more significant factor in the drop in sales of Japanese automobiles in China. On the other hand Chinese Imports for the first time saw a slight decline in 2013 but still continue to be the mainstay of Japanese Economy.

Chinese Exports worldwide comprise of electromechanical products (57%) and labor intensive products such as clothing, textiles, footwear, furniture, plastic products, bags and toys (20%) forming the major share². Imports of high-value added communication devices such as semiconductors, smart phones, photoelectric cells to be used for solar panels have increased drastically in view of continuous rising demand. However sales of electronic items have been sluggish triggered by rush demand ahead of the end of the eco-point system that began in 2009 in Japan as a subsidy plan for consumers to trade in their old appliances and television sets for more energy-efficient models. Imports of transportation equipment from China mostly maintained at a high level, as those of automobiles and car components showed an increase together by double digits. Especially, car components such as gearboxes, clutches and drive shafts showed a sharp increase. Seasonal and low-value added Chinese imports fell in absolute terms due to continuing trend of shifting production facilities from China to other Asian countries and regions in search of lower production cost. China's share of Japan's clothing imports was 71.5%, down from 74.4% in 2012 while Vietnam's share was 8.6%, up from 8.2% in 2012. Myanmar's and Indonesia's shares each increased to 3.0%, up from 2.2%. Only imports of high-value clothing

² <http://www.tradingeconomics.com/china/exports>

such as suits and dresses showed a modest rise. Foodstuffs from China and other raw materials such as iron and non-ferrous metal imports also saw massive decline³.

The expansive reach of regional production networks in East Asia that brought immense prosperity to the region in a short time also cannot afford any breakdown in the production sharing and trade in components and parts accounts for well over half of total network exports(imports) for most countries in the region. China- Japan economic relations are hence not significant just in view of their huge trade but also in being a part and linked to each other in a larger network that contributes about 26% to World GDP – a similar share as North America. A decline from \$334 Billion bilateral trade in 2012 to \$312 Billion does not make trade relations insignificant in as far as China-Japan relations are concerned. Foreign companies and joint foreign-Chinese ventures account for more than 25% of China's entire industrial output, 39% of its apparel exports, and 99% of its computer exports. And these companies rely on imports from Japan. China cannot single out Japanese products without damaging and alienating the network of multinational companies that are

fueling China's march up the value chain and toward higher living standards. Around 60-70% of the goods China imports from Japan are the machinery and parts needed to make China's own

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³ "JETRO survey: Analysis of Japan-China Trade in 2013 and outlook for 2014" at <http://www.jetro.go.jp/en/news/releases/20140228009-news>

products. China cannot cut off this flow, or risk disrupting it through conflict, without crippling its economy⁴.

Japan at the moment is mired in confusion of what path to take. There is no written fact stated anywhere that the political leadership opinion is equivalent to majority opinion in a country. Wherein Abe seeks to fulfill his agenda of normalizing the country and regaining prestige through military autonomy, the backlash during the 67th anniversary of the adoption of the Peace Constitution⁵ (3rd May) makes it very clear that Japan is split on the issue of the revision of Article 9. Also despite all the flaring up of tensions, China and Japan went ahead with the scheduled talks of China-Japan-South Korea FTA with the third round in Tokyo right two days after the ADIZ was declared in late 2013 by China in East China Sea. A fourth round in Seoul in March and fifth round to be held in Shanghai in July this year clearly show that China and Japan both value their economic ties to each other. At a time while PM Shinzo Abe was signing an accord with NATO⁶ at its Brussels headquarters on 7th May to deepen Japan's cooperation with the Western military alliance in areas such as counter piracy, disaster relief and humanitarian assistance, nine Japanese politicians of both ruling and opposition parties belonging to the *Japan-China Friendship Parliamentarians' Union* met foreign minister Tang Jiaxuan and other Chinese officials in an effort to arrange a summit between Xi Jinping and Japanese PM Shinzo Abe⁷. Japan should take heed of Obama's advice in his recently completed tour of Asia to resolve the historical legacies once and for all to better push for a more stable and an even richer East Asia region.

(Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the position of the Centre for Air Power Studies - CAPS)

⁴ Richard Katz, "Mutually Assured Production: Why Trade Will Limit Conflict Between China and Japan", *Foreign Affairs*, July/Aug 2013 from <http://www.foreignaffairs.com/articles/139451/richard-katz/mutual-assured-production>

⁵ "Japan split over revision to pacifist constitution", 4th May 2014 at http://www.washingtonpost.com/world/asia_pacific/japan-split-over-revision-to-pacifist-constitution/2014/05/03/a76f265e-d333-11e3-8f7d-7786660ff7c_story.html

⁶ "Abe, worried about China, strengthens partnership with NATO", 7th May 2014 at <http://www.japantimes.co.jp/news/2014/05/07/national/politics-diplomacy/abe-worried-about-china-strengthens-partnership-with-nato/#.U2m-Q4GSyGM>

⁷ "Japan and China seek to mend ties at talks", 4th May 2014 at <http://www.rte.ie/news/2014/0504/615156-china-japan/>