Economic Integration in East Asia and Japan-China Business Alliance

Keynote Address by Osamu Watanabe, JETRO Chairman and CEO
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Introduction

Let me first express my gratitude from the bottom of my heart to Mr. An Min, Honorable Vice-Minister of Commerce. Thank you very much for coming all the way here to join us today and for giving us your heartfelt greeting, despite your always-busy schedule.

I also wish to extend my gratitude to Mr. Yu Ping, Honorable Vice-Chairman of the China Council for the Promotion of International Trade. Thank you very much for your all out cooperation in helping us organize today’s symposium.

I would also like to express my gratitude from the bottom of my heart to the people—both on the Chinese and Japanese sides—who have cooperated in holding today’s symposium, as well as to the large number of people who are present at today’s symposium.

Just five years have passed since my last visit to Beijing in May of 1999, when I (as Japan’s then Vice-Minister of International Trade and Industry) held inter-governmental consultations with Mr. Li Rong Rong, the then Vice-Chairman of the State Development Planning Commission. I recall that during this visit the streets of Beijing were filled with anti-American demonstrators, in the wake of Premier Zhu Rongji’s visit to the United States, in which he failed to win an agreement on China’s accession to the WTO. The visit was also concurrent with the air attack on the Chinese Embassy in Yugoslavia.

Up to then, we had been consistently supporting China’s accession to the WTO, believing that China should become a country run on international rules as early as possible, in the interest of both China and the world. I retired as Vice-Minister in 1999, but I have been really impressed by the fact that, since its accession to the WTO in late 2001, China has tackled various reforms, undertaken a large volume of legislative work and steadily developed its economy, all the while abiding by WTO rules.

I would like to pay my heartfelt tribute to the efforts of the Chinese government and the people who have made this progress.

Status Quo of the Japanese Economy and Corporate Activities

I am looking forward to hearing today interesting stories and experiences from Japanese and Chinese business leaders in this day devoted to “Economic Integration in East Asia and Japan-China Business Alliance.” But let me first present my personal view on the
future prospect for East Asia (an area that has been undergoing rapid economic integration), as well as offer my perspective on roles played by Japan and China under such circumstances.

I would like to first begin with the Japanese economy, which had long remained in a slump but has finally entered the last phase of structural reform. The economy has been picking up since June of last year. This upward trend is supported by years of successful corporate efforts at restructuring—that is, a sharp recovery in companies’ profitability thanks to the near elimination of the so-called three excesses—namely, excessive facilities, employment and debts.

In addition, one must credit part of the recovery to a surge in capital spending in line with the recent boom in digital products.

However, I believe that while the three excesses have been greatly reduced, there remains work to be done. Companies must take aggressive restructuring measures in earnest, in order to establish a future profit structure and completely shed unprofitable businesses. Therefore, companies should make further efforts to achieve structural reform. Together with these efforts in the private sector, the Japanese government should also make further efforts, without growing complacent in the time of a recovering economy. These are my observations on the current state of the Japanese economy.

I estimate that because the results of these restructuring efforts will have a deflationary impact on the Japanese economy as a whole, it will take perhaps another two years for the economy to achieve a full-fledged recovery.

However, I have a very bright outlook for the Japanese economy—after its achievement of a full recovery in two years’ time. I say this because I feel that a new business model, which allows companies to generate profit through integrated operations with East Asia, has steadily begun to take root in Japanese companies over the past three years.

**China Not a Threat but an Opportunity**

About three years ago, the Japanese economy was in a severe trough and the sentiment of Japanese businesses was at its worst. The theory of a “Chinese threat” was then very much talked about in Japan. The situation has now greatly changed.

In step with the development of the Chinese market, not only big enterprises, but also small-and-medium-enterprises (SMEs) and middle-ranking companies, are willing to go out to do business in the Chinese market, determined not to miss business opportunities. This represents a substantial change in business sentiment.

At the Boao Forum for Asia held in April 2002, Prime Minister Koizumi said, “China’s development presents a challenge and an opportunity for Japan, not a threat.” This
remark must still be fresh in your memory.

China’s economy has been steadily expanding in recent years. Furthermore, there has been increased investment in China related to the country’s growing domestic demand—in such fields as processed foods, miscellaneous goods, cosmetics, etc. In addition, 2003 saw expansion of Japan’s exports to China, to meet with this increasing domestic demand. As a result, companies such as steel makers, nonferrous metal makers and construction machinery makers enjoyed a sharp recovery in earnings. Needless to say, the Japanese economy’s recent recovery trend is largely attributed to China’s economic development.

Network Formed in East Asia

To date, Japanese investment in China has been small in comparison with its investments in the US and Europe. Although Japan’s investment in China has been growing sharply since 2000, it still accounts for only some 8% of Japan’s global investment, on a flow basis.

By contrast, Japan’s investment in ASEAN and NIEs countries combined stood at around 10%, in recent years.

Furthermore, Japan’s cumulative investment in the five ASEAN countries in 1951-2002 amounted to the equivalent of 3.3 times as much as Japan’s investment in China during the same period. Japanese companies are now running production bases in three regions: Japan and China, plus ASEAN countries (with which Japan has a long history of relations)—to adopt a strategy of selecting the best places for production and procurement. I see this as a new business model, in which East Asia is regarded as one economic entity.

Regional trade in East Asia has expanded rapidly against the backdrop of increasing integration of business operations in East Asia among Japanese and other companies. During 1985-2002, global trade grew 3.3 times. Surprisingly, regional trade within East Asia, comprising of Japan, China, Republic of Korea, Hong Kong, Taiwan and ASEAN surged 6.4 times, double the growth in global trade during the same period.

During the 1980s, Japan depended on the US for more than a third of its exports. At that time it was said that when America sneezes Japan catches a cold. However, as Japan’s trade with East Asia grew, its dependence on the US as an export market has become less and less: it now stands at around 24%.

On the other hand, the ratio of Japan’s imports from the US to its overall imports has also been falling sharply, currently standing at around 15%.

By contrast, the current ratios of Japan’s imports from and exports to East Asia both stand at around 45%—and are expected to exceed 50% soon.
Japan amid Integration with East Asia

Since the end of World War II, Japan has been working to strengthen its international competitiveness by concentrating production facilities within the country and exporting mass-produced products that are well priced and of high quality.

In the 21st century, however, Japan is expected to pursue economic growth together with East Asia, by locating production bases on the Japanese archipelago, the Korean Peninsula, China, Hong Kong, Taiwan and the whole ASEAN region.

The economy in East Asia, as a whole, will flourish thanks to activities in investment, imports and exports, as well as the interchange of people. Once integration has progressed to a high degree, each country in the region will be able to reap the benefits of this growth, commensurate with their degree of economic development. In my scenario for East Asia in the 21st century, I see the win-win situation of an integrated economic area as a distinct reality.

This trend is being witnessed not only in East Asia, but also in North America, where NAFTA now includes much of Latin America, and in Europe, where the EU now numbers 25 countries, after recently welcoming 10 new members. East Asia, however, is said to be lagging behind, as NAFTA and the EU progress toward integration. In fairness, over the past several years I believe that East Asia has come very far in matching those two pillars, achieving rapid economic integration—thanks in part to the emergence of China as a driving economic force. Regarding this point, Prof. Fukunari Kimura of Keio University said, “An international network of production and distribution has been created in East Asia in the past decade, centering on the electric and electronics sectors. A production network on this scale is unseen on the American Continent or in Europe.”

Need for FTAs in East Asia

The biggest problem now appears to be how to prevent the existence of national borders from hindering economic integration, which has been progressing in East Asia as a matter of course.

Japan recently entered into negotiations with Korea to conclude a free trade agreement (FTA). Since last December’s ASEAN-Japan Commemorative Summit Meeting in Tokyo, the Japanese government has begun FTA negotiations with Malaysia, the Philippines and Thailand. Furthermore, Japan is set to start talks in 2005 to conclude a comprehensive economic partnership with ASEAN as a whole.

Meanwhile, the Chinese government has been striving to conclude an FTA with ASEAN. The integration of the East Asian economy, which has been taking place on a de facto basis, is now starting to take a more institutional form. I think these moves are coming at the right time.
Japan-China Business Alliance

I believe that both Japan and China, as the two economic leaders in the region, should play a considerable role in furthering and deepening economic integration in East Asia. To this end, it is important for Japanese and Chinese companies to also further deepen and expand their business alliances.

Private-sector companies should play a leading role in building multifaceted business alliances between Japan and China.

At the same time, the governments of both countries should play a role in accelerating development in East Asia, by making it possible for companies in both countries, without being disturbed by borders, to share freely four principal business resources—i.e., materials, money, human resources and intellectual property. This can be achieved through the harmonization and rigorous implementation of legal systems and rules.

An initial model of business alliances between Japanese and Chinese private sector companies may take the form of a combination of China’s excellent business resources and Japanese companies’ technologies and capital. When I refer to China’s "excellent resources," I mean exceptional and abundant low-cost labor, the concentration of parts industries in the Pearl River and Yangtze Deltas, as well as Chinese knowledge and expertise.

An appropriate next step is business tie-ups between companies in both countries. In fact, various forms of such alliances are progressing already, such as Chinese companies selling products made by Japanese companies, Japanese companies entrusting production to Chinese companies, or Chinese high-tech ventures consigning production to Japanese companies, among others.

A deeper form of alliance is expected in the future, in which Japan and China work together on the joint creation of intellectual property. Such examples may include joint research and development projects involving companies, research institutions, and universities in Japan and China, making full use of China’s expertise and know-how. As for concrete developments in that direction, I would like to wait for remarks to be given today by speakers from NEC Corporation, Advanced Technology & Materials Co., Ltd. and Ishikawajima-Harima Heavy Industries Co., Ltd. (IHI).

However, sizeable issues remain to be resolved in both Japan and China, in order to further accelerate the widening and deepening of business alliances between the two countries.

Issues Facing China
There are two issues facing China in its advancement toward economic integration. The first is for the country to realize sustainable growth in a broad sense. The other is for China to consolidate its economic legal system, in particular areas dealing with the protection of intellectual property. Both of these are essential for developing and strengthening business alliances.

For China to realize sustainable economic development, there are three important structural reforms that must be carried out: 1) improvements in “three farm-related aspects”—farming, farming villages and farmers; 2) privatization and improvement of competitiveness of state-owned enterprises; and 3) rectification of regional disparities. Without solving these issues, I believe it will be very difficult for China to achieve sustained growth.

Furthermore, the idea of sustained growth in a broad sense, in my view, requires efforts to maintain harmony with nature, through energy conservation, environmental preservation and resolution of water shortages—while at the same time working to prevent the economy from overheating. It is also important to pursue “peaceful ascendancy” and not pose threats, economic or otherwise, to neighboring countries.

On these issues, new administration members General Secretary Hu Jintao and Premier Wen Jiabao expressed their views in a very candid manner at press conferences after their inauguration, and on other occasions.

Also, Premier Wen Jiabao, at an emergency ASEAN summit held in Bangkok in late April last year, in the wake of the SARS epidemic, admitted very frankly that China lacked experience in this area and its system for coping with such situations was imperfect. At the same time, he expressed China’s intention to earnestly respond to criticism from ASEAN countries, by making proactive proposals, such as the creation of a transparent network of information distribution and an international framework of cooperation in the fight against SARS.

As I mentioned earlier, the candid and earnest attitude shown by Chinese leaders has given the country a sense of transparency, and served to bolster the confidence of East Asian countries that share the same problems. I believe that if such transparency, candor and sincerity can spread to each region and level of Chinese society, the country could become a big driving force in East Asia’s integration.

I firmly believe that China recognizes the difficulties it faces, and will move to address important issues ahead on. As Japan has also faced similar problems in the past, we are ready to share our experiences, provide technologies and send specialists—in short, meet any form of request made by the Chinese government.

On the Protection of Intellectual Property
Another important issue facing China is the protection of intellectual property. As Vice-Minister An Min mentioned earlier, one of the purposes of my visit to China this time, as a member of the government-private sectors joint mission, is to request that the Chinese government enforce intellectual property right protection. I do not need to reiterate that there are many problems in this area, such as a large number of repeat violators and a lack of proper execution of laws in the field after their introduction. I came here to seek improvement in the laws, systems and criminal procedures that are aimed at cracking down on violators.

To seek resolution of issues relating to intellectual property, I spent two and a half days visiting the heads of seven government agencies. In these talks with Premier Wen Jiabao and other key government figures, I was very impressed by the fact that everyone strongly recognized intellectual property issues as China’s own problem. Mission leader Mr. Munekuni, the chairman of Honda Motor Co., Ltd., shared my impression. Furthermore, I was very impressed by their clear determination to tackle the matter, which is a completely different story from the reaction received by the mission 18 months ago.

At the same time, these agency heads told us that it would take some time for everyone to thoroughly recognize these problems. I agreed, because I understand China’s difficult situation, given the country’s huge population and geographic area and the widespread production and distribution of pirated material.

I think that without resolution of the intellectual property problem, it will be difficult for China to truly win the confidence of the world, and there will be no true advancement of a Japan-China business alliance. However, I fully recognize that this will not be an easy task. It is admittedly very hard work to penetrate throughout China’s vast regions a new consciousness on intellectual property. I firmly believe that measures to crack down on violators will be thoroughly carried out under the strong leadership of top-level officials of the Chinese government. Japan must also make all out efforts to offer assistance. We are ready to draw on our experiences and offer cooperation at the first request from the Chinese side.

**Japan’s Experience in Protection of Intellectual Property**

Japan introduced many technologies from Europe and the US after World War II. In technical tie-ups with European and US companies, Japan was engaged in post-war reconstruction. However, as exports increased, the country invited criticism that Japanese products were all counterfeits, and the image of Japanese products as “cheap and low quality” took root in the global market. Government and businesses fought hard to overcome this image, and managed to establish “Japan Brand,” which became an assurance of unrivaled quality. I will not go into the details today, but would like to offer further assistance, as necessary, concerning Japan’s experiences which contain many points that should be useful not only for China’s central government, but also for regional
governments and companies as well. Utilizing official development aid budget, the Japanese government has already been offering assistance on this problem by fostering Chinese intellectual property experts and sending experts from Japan. We would like to continue wide-ranging assistance to meet requests from the Chinese side.

Problems Facing Japan and Promotion of Investment in Japan

I have pointed out the problems facing China over economic integration with East Asia. Japan, too, is also faced with some big problems. Japan’s population will start to decline in 2007, by which time the country will enter the era of an aged society. By 2030, more than 30% of Japan’s population will be aged 65 or over, compared with 23-24% expected in France and Britain and 20% in the US—by the same year. Thus, at a very fast pace, Japan will become an aged society, in which there will be no increases in the labor force or expansion in capital accumulation. Under such circumstances, a country needs to change its economic structure so that total factor productivity may be raised—in order to maintain vigor in the economy. Therefore, Japan must drastically change its economic structure into one led by more value-added sectors (Japan must also actively promote service industries that suit the needs of an aged society). For speedy implementation of these processes, Japan must continue structural reform of its economic society, borrowing ideas and know-how from around the globe. To look at one specific example: welfare services in West European countries, which will become an ageing society as well, have a large accumulation of experience and know-how. For improved productivity, Japan may look to East Asia on this score.

In short, I believe that Japan must change its economy and society—with the assistance of other countries—by actively introducing excellent capital, technologies and know-how, and by bringing in the best outside human capital. By such moves, I believe that Japanese business people and companies will be stimulated by the ensuing competition, causing Japan to transform itself into a new economic society.

This is the very basic objective pursued by Prime Minister Koizumi in his “Program to Double Japan-bound Investment.” The amount of foreign direct investment into most major countries makes up around 20-30% of their GDP (the ratio for China may be higher). However, the FDI ratio for Japan stands just above 1%. Which is why I believe that Japan, as I just stated, must promote economic reform by actively taking in foreign capital and other assets.

In order for this reform to take hold, every system in Japan must naturally be made more open. Japan’s economic systems have become open in both nominal and real terms, as a result of structural reforms conducted since 1996—such as deregulation in sectors like distribution, major structural and financial reform (i.e., the financial Big Bang), as well as the termination of lifetime employment system and the adoption of international accounting standards. European and American business people, who had once loudly criticized Japan, have ceased to claim that Japan is a closed society. However, I believe that Japan must
promote a second wave of restructuring aimed at prying open Japanese society still further, with the ultimate aim of making the country a more comfortable and welcoming environment for foreigners.

Chinese companies are increasingly advancing into overseas markets. As the economic integration of East Asia progresses and China develops and becomes further revitalized, a rising number of Chinese companies are expected to enter the Japanese market. There have already been several examples of such entrances: the acquisition of Akiyama Printing Machinery by Shanghai Electric; and the purchase of a medium-sized pharmaceutical maker in Japan’s Toyama Prefecture by the Chinese Sanjiu Enterprise Group in Shenzhen. Many presidents of young Chinese venture businesses gathered in Kyoto and Osaka last year for various business matching and information symposia. During these events, hundreds of conferences were held between Japanese and Chinese business people, among them Mr. Cai Rang, president of Advanced Technology & Materials Co., Ltd. who is present at today’s symposium. Such events are also scheduled for this year. We wholeheartedly welcome such events and wish for further entry into the Japanese market by Chinese companies.

**JETRO’s Roles**

As Japan-China business alliances gain strength—and as Japan and China step up cooperation—JETRO will continue to play several important roles in promoting economic integration in East Asia.

First of all, by fully mobilizing staff in its Tokyo and Osaka headquarters and 36 regional Japan offices, JETRO provides various information and support to Japanese SMEs—as well as middle-ranking companies—seeking to advance into Chinese markets. In addition, JETRO’s offices in China support Japanese affiliates (especially SMEs) on all issues relating to local operation, such as those concerning labor, legal aspects, taxation and intellectual property.

Secondly, JETRO offers assistance to Chinese and other foreign companies planning to invest in Japan. In May of last year, with much fanfare and an opening ceremony attended by Prime Minister Koizumi and other distinguished guests, JETRO opened the first Invest Japan Business Support Center (IBSC) in Akasaka, Tokyo. Foreign business people can now receive one-stop support and information on all issues relating to investing in Japan.

As I mentioned earlier, the Chinese government is encouraging Chinese companies to make overseas investment. I hope many Chinese companies will advance into the Japanese market and actively utilize JETRO’s IBSC, which boasts more than 30 private office spaces that can be used for 2 months free of charge.

The third area in which JETRO can play a role is by promoting the expansion and strengthening of Japan-China business alliances. As I already stated, there appears to be
room for JETRO to offer assistance in various fields, such as improvement in and stricter enforcement of economic laws, including those for the protection of intellectual property, which the Chinese government have introduced. JETRO can also offer assistance in sharing technologies relating to energy and environmental protection, as well as provide various types of assistance in improving China’s investment climate, on the basis of opinions gathered from Japanese companies.

On the issue of protection of intellectual property, I will not repeat what I have already said. We held a seminar on the enforcement of intellectual property rights protection in Hangzhou, Zhejiang Province this past March, which was energetically welcomed by some 60 Chinese law-enforcement officials. Together with mission leader Mr. Munekuni and others, we talked about this enforcement seminar yesterday with Vice-Minister of Commerce, Mr. An Min, who is present at today’s symposium. Mr. An Min warmly responded, agreeing to the idea of holding similar enforcement seminars in regional cities, through cooperation between JETRO and the Chinese government.

On the fourth point, JETRO operates the Institute of Developing Economies (IDE), which is involved in conducting comprehensive research and surveys on a host of issues in developing countries and regions. An East Asia free business zone can be said to begin when Japan and China’s combined GDPs account for 80% of the region’s total GDP. Under the current circumstances, I think that studies on desirable trade and investment rules between Japan and China, as well as their impacts on trade and investment in East Asia as a whole, should be conducted. I believe the time has come for IDE to undertake such studies, jointly, with relevant Chinese research institutions. And I believe an East Asia free business zone will start to become a reality faster than most are anticipating. JETRO has been undertaking various projects at its four China offices: Beijing, Dalian, Shanghai and Hong Kong. To further enhance operations, JETRO plans to raise the number of its offices in China to six, by opening an office in Guangzhou, Guangdong Province in May, and one in Tsingtao this autumn.

Conclusion

I have spoken about economic integration in East Asia and Japan-China business alliances. A number of problems remain to be resolved or dealt with both in China and Japan. But I firmly believe that an East Asia economic zone, full of bright prospects, will be created if Japan and China can cooperate in a truly openhearted manner.

Looking back at history, China gave birth to some truly great ancient civilizations, and has made a significant contribution to mankind—by spreading the fruits of these civilizations, over land and sea, to the Korean Peninsula, the Japanese Archipelago and to the rest of the world.

I fully recognize there was a very unfortunate period during the 20th century.
But I sincerely hope that, in the 21st century, Japan and China will overcome any past histories, and proceed hand in hand in transforming East Asia into an economic zone. Together, the two countries can help create an area that is free, affluent and full of diversity, matching similar economic areas to those in Europe and North America. I earnestly hope that Japan and China will join forces so that East Asia may become a community that not only produces products, but also creates new intellectual property assets—and indeed a new civilization that appeals to the world and contributes to the peace and prosperity of the planet. Thank you very much for listening to my views on economic integration in East Asia and the future of Japan-China business alliances.