Economic Integration in East Asia and Japan-China Business Alliances

Speech by Osamu Watanabe, Chairman and CEO of JETRO
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Introduction

Ladies and gentlemen, I would like to thank you for coming all the way here to join us today at the official opening of JETRO Qingdao. I am truly honored to welcome so many distinguished guests, whose names are too many to mention—although I am deeply gratified all the same.

First, please allow me to give you a brief history of my involvement in Japan-China relations. I worked for the Ministry of International Trade and Industry (MITI, the predecessor of METI, the Ministry of Economy, Trade and Industry) from 1964 to 1999, and became Chairman and CEO of JETRO in July 2002.

My first visit to China was in 1988, when I accompanied (as a Secretary to the prime minister) the then Prime Minister Noboru Takeshita on his official visit to China. After having consultations with the then Chairman Deng Xiao Ping and the then Premier Li Peng in Beijing, our mission visited Dun Huang, where I was amazed to see the mural paintings in the Mogo Caves. During my first visit to China, I was deeply impressed by China’s wide and majestic expanses of land, as well as the long history and great culture it represents.

I visited Beijing for the second time 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.

Although I retired from my Vice-minister position in 1999, I have closely followed the progress of China. I have been greatly impressed by the country’s efforts—since its accession to the WTO in late 2001—to tackle various reforms, undertake a large body of legislative work and develop 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.

JETRO’s Role and Offices in China

I would now like to briefly introduce JETRO. We are a government-related agency committed to promoting Japan’s global trade and investment, with 77 overseas offices in 57 countries, including our
new office here in Qingdao. We have been working very closely with China’s Ministry of Commerce and the China Council for the Promotion of International Trade (CCPIT).

At the time of its foundation in 1958, JETRO was focused on revitalizing the Japanese economy through export promotion. In the 1980s, however, as trade friction between Japan and the West intensified, JETRO’s mission shifted toward import promotion and greater economic cooperation with developing countries. After merging with the Institute of Developing Economies (IDE) in 1998, JETRO has been devoted to promoting Japan’s trade and outward foreign direct investment (FDI), reinforcing business partnerships (especially in East Asia), and promoting inward FDI.

JETRO has had a Hong Kong office since our foundation. As China’s reforms and opening-up progressed—and economic exchange between the two countries developed—JETRO went on to set up offices in Beijing, Shanghai and Dalian between 1982 and 1993.

Until the opening of JETRO Guangzhou this past May, our Hong Kong office alone served the South China region. The Guangzhou office was opened in response to the expansion of Japanese companies from Shenzhen into the whole of the Pearl River Delta (PRD) region, and the growing accumulation of auto industry businesses in Guangzhou. The establishment of JETRO Guangzhou did not simply mean the opening of JETRO’s fifth office in China; it also corresponded with the increasing importance of the PRD region as an area that is broadening interchange between China and ASEAN, and expanding production and distribution networks in the context of “East Asian economic integration.”

Today you have witnessed the opening of JETRO’s sixth China office. The importance of Shandong Province, as we all know, lies not only in the fact that it is the birthplace of China’s ancient civilizations, but that it is the third largest economic sphere in the country and enjoys a close economic relationship with Japan—through trade and investment in agriculture/fishery, food processing, textiles, machinery and electric industries. Moreover, I would like to stress that JETRO Qingdao was set up as a response to the firm resolve of China’s central and local government leaders in the Bohai rim area to develop the region’s economy through regional solidarity and closer cooperation among Japan, China and the Republic of Korea (ROK).

Now, I would like to sketch out a perspective of East Asia, where economic integration is rapidly progressing, and give my personal view on the role that China and Japan can play in that picture.

**Japanese Economy and Corporate Activities**

The Japanese economy, which had long remained in a slump, has finally entered the last phase of structural reform—and 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 the profitability of many companies, thanks to the near elimination of the so-called three excesses, namely: excessive facilities, employment and corporate debt. 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 one and a half to 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—in which companies generate profit through integrated operations with East Asia—has steadily begun to take root in Japanese business strategies over the past three years.

**China Not a Threat but an Opportunity**

About three years ago, when the Japanese economy was in a severe trough and confidence among Japanese businesses people was at its lowest, the “Chinese threat” was then much talked about. Today, China is no longer viewed as a threat, but rather an opportunity. As the Chinese economy grew and the potential of its enormous domestic market was fully realized, Japanese companies of all sizes looked to the country, determined not to miss out on the growing business opportunities there. This represents a clear shift in business sentiment toward China.

At the Boao Forum for Asia 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 minds.

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 electric/electronics, automobile, housing and construction, as well as daily necessities like processed foods and cosmetics. Investment in heavy industry is spreading into upstream industries such as chemicals and steel sheets for automobiles. 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 have enjoyed a sharp recovery in earnings. Needless to say, Japan’s improved economic situation is due in large part to the explosive growth of China.

**Integration of East Asian Economy**

To date, Japanese investment in China has been small in comparison with that made by the US and Europe in the country. Although Japan’s investment in China has grown sharply since 2000, it still accounts for only 8.7% of Japan’s global investment in 2003, on a flow basis. By contrast, Japan’s investment in ASEAN and Asian NIEs combined has stood at around 10% in recent years. Furthermore, Japan’s cumulative investment in ASEAN 5 between 1951-2003 amounted to more than three times what was made in China during the same period.

Japanese companies are operating a new business strategy in East Asia, whereby companies locate production bases across three regions—namely, Japan, China and ASEAN, with which Japan has a long history—in order to take advantage of the relative strength of each area. In this new strategy, companies
choose the optimal location for each stage of production, procurement and distribution, treating all of East Asia as one economic entity.

Regional trade in East Asia has expanded rapidly against a backdrop of increasing integration of Japanese and regional companies. From 1985 to 2003, global trade grew four times in value. Surprisingly, the value of regional trade in East Asia, comprising Japan, China, ROK, Hong Kong, Taiwan and ASEAN countries, surged 7.8 times, or nearly double the growth in global trade during the same period.

Accordingly, the current ratios of Japan’s exports to and imports from East Asia stand at 47% and 43%, respectively; both are expected to exceed 50% soon.

Since the end of World War II, Japan has worked 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 and throughout the whole ASEAN region.

The East Asian economy 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.

**Japan-China Business Alliance to Drive East Asian Economic Integration**

The major driving force behind East Asia’s economic integration is cross-border business alliances. Business alliances formed between Chinese and Japanese companies are mainly a combination of China’s excellent business resources and Japan’s innovative technologies and abundant capital. When I refer to China’s “excellent business resources”, I mean exceptional and abundant low-cost labor, the concentration of parts industries as well as Chinese knowledge and expertise.

The PRD region could serve as a good example of how Japan-China business alliances make the best use of low-cost labor. In the 1990s, the region saw a highly competitive concentration of manufacturing industries, from makers of finished products to parts makers, producing everything from textiles to photocopy machines, printers and personal computers.

JETRO began providing assistance to Japanese firms operating in the area, helping them source parts and materials locally, which in turn benefited local Chinese parts suppliers eager to develop business ties with Japanese affiliates. In 1996, JETRO began holding parts and materials trade fairs in Shenzhen to help local businesses broaden their opportunities. At these trade fairs, aptly named “reverse exhibitions”, Japanese assemblers displayed sample parts and materials (not completed products) that they wished to procure locally; this lead to numerous and valuable business opportunities on both sides.

In the Bohai-rim area, movements towards strengthening partnerships among Japan, China and ROK
lead to the formation of business alliance among companies from these three countries. Based on an inter-governmental agreement, a joint study on a trilateral FTA was launched. Another agreement, which was made at the trilateral summit meeting including Japan, China and ROK in November 2003, led to the launching of a joint study (which began in March 2004) on the Japan-China-Korea trilateral investment arrangement, involving industrial, academic and governmental sectors. The study groups working on this project will report to the summit leaders at a trilateral meeting to be held in Lao People’s Democratic Republic in autumn of this year. Such cross-border collaboration is credited with helping build business alliances between these countries.

The Chinese government, led by its Ministry of Commerce, also places a particular emphasis on strengthening the economic partnership between Japan, China and ROK, and every year holds a forum or a trade fair that focuses on economic cooperation in the Bohai rim region. In line with this movement, JETRO participated in a parts and materials trade fair in Weihai last year. This past August, JETRO organized Japan pavilion, featuring 52 companies, in a similar fair held in Tianjin, and simultaneously co-organized a forum on trilateral collaboration in Bohai rim area, where I served as one of the speakers.

It is my firm belief that promotion of trilateral partnerships among Japan, China and ROK plays an important role in East Asian economic integration as a whole, and is one of JETRO’s key missions. Our task will be greatly facilitated by the new Qingdao office, which will work together with other JETRO offices in this part of China (namely Beijing and Dalian) as well as our Seoul office.

Mr. Shin Hyung-Keun, ROK Consul General in Qingdao, and Mr. Kim, Director of the Qingdao Trade Center (KTC Qingdao) of the Korea Trade-Investment Promotion Agency (KOTRA), both attended the JETRO Qingdao ribbon-cutting ceremony, held shortly before my speech. In a happy coincidence, the Hisense Tower building, in which our new office is located, also houses KOTRA’s Qingdao office. To maximize the close proximity of our offices, I would like to join hands with Mr. Kim and KTC Qingdao in working toward a common goal of driving economic integration in East Asia through strengthening partnerships among Japan, China and ROK.

In Shangdong Province we have seen an increasing concentration of leading Chinese electronics companies such as Haier and Hisense—companies that are very active in seeking international business alliances and partnerships. A good example of such an alliance was seen at a trade fair this past July in Tokyo. The fair, called China-Japan Technomart 2004, jointly organized by JETRO and China’s Ministry of Commerce, provided 35 leading high-tech Chinese companies an opportunity to showcase their products and technologies. Over 200 Japanese companies visited this two-and-half-day fair, which was the first of its kind for the government of China. Business matching negotiations led to some 450 business contracts, worth up to 1.9 billion yuan, or US$230 million. I have happily heard that there are many more on-going business negotiations, as a result of the fair. Because of this success of this July fair, I was made very much aware that there is boundless opportunity for the Japan-China business alliance.

As you all know, Shandong Province is China’s largest production area for a wide range of products, from...
beer, cement and chemical fertilizers to woven fabrics and home electronic appliances. The province is also a very attractive destination for foreign direct investment because of its well-built roads. And Shandong boasts many leading research facilities, such as the Institute of Oceanography and Ocean University of China/Qingdao, which focuses on research and surveys in the field of marine science. Such institutes are helping to build the fundamentals needed to create new and unique intellectual property. We think the province offers considerable opportunity for exploring this new form of business alliance, for which JETRO will provide support services in the form of abundant business resources.

Given the facts and success stories I have just spoken about concerning the region—and to commemorate the opening of our Qingdao office—I would like to propose holding an international event here in Qingdao. The event could be next year, for instance, in the form of an international trade fair for parts and materials that would enhance partnerships among Japan, China and ROK. The fair could bring together electric/electronics, auto, and machine manufacturers and relevant parts suppliers from all three countries; manufacturers can display parts and materials they wish to procure while parts suppliers can showcase part/component products they wish to sell. The event, which would of course involve ample opportunity for business partnering, would be a valuable opportunity for all parties. I would like to open a dialogue with China’s Ministry of Commerce and the Qingdao city government, via our new Qingdao office. I pledge to do my best to make this ambitious event a reality and a success.

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

Challenges for China

China, with its vigorous economic growth, is now in the center of world attention. However, in order to sustain this growth, China must cope with some challenges. First, there are three important structural reforms that must be carried out: 1) improvements in “three farm-related aspects”—farming, farming villages and the farmers themselves; 2) privatization and improvement of competitiveness of state-owned enterprises; and 3) rectification of regional disparities. Moreover, the idea of sustained growth, in my view, requires efforts to maintain harmony with nature, through energy conservation, environmental preservation and resolution of water shortages—all while working to prevent the economy from overheating. Lastly, it is important to pursue “peaceful ascendency” and not pose threats, economic or otherwise, to neighboring countries.

On these issues, China’s 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 last year, in the wake of the SARS epidemic, admitted very frankly that China’s 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.
The fact that the top Chinese leader admitted to the country’s core problems—in such a candid and earnest manner—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 an even bigger driving force in East Asia’s integration.

I firmly believe that China recognizes the difficulties it faces, and will move to address important issues head on.

Another extremely important issue facing China is the protection of intellectual property. A joint mission drawn from Japan’s government and private sectors, made up of 86 delegates, including myself, visited Beijing and Guangdong in May 2004 to pursue issues related to the protection of intellectual property rights.

JETRO played a central role in organizing this mission, which spent two and a half days in Beijing, visiting the heads of seven government agencies. In 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. Their clear determination to tackle the matter struck a clear difference from the reaction received by the mission sent back in December 2002. Indeed, the leaders this time around expressed their firm belief that protection of intellectual properties was an absolute necessity—not for the sake of other countries but for China itself to continue growing.

At the same time, these agency heads told us that it would take some time for everyone to thoroughly recognize these problems, but that they would take every measure to resolve them. I understand China’s difficult situation, given the country’s huge population and geographic area. But I think that without resolution of the intellectual property problem, it will be difficult for the country to truly win the confidence of the world; and there will be no true advancement of a Japan-China business alliance.

However, I have no doubt that China will be able to overcome its challenges on structural reforms and intellectual property rights issues, given the strong will and determination of the country’s leaders. As Japan has also faced similar problems in the past, we are ready to share what we have learned—from experience.

**Challenges for Japan**

I have pointed out the problems facing China as the country works toward East Asian integration. But Japan, too, faces some big problems. As you know, for a country to achieve economic growth, it needs 1) growth in population, 2) capital accumulation and 3) improvement of total factor productivity. However, Japan’s population will start to decline in 2007, when the country will enter the era of an aged society. Under such circumstances, Japan needs to change its economic structure so that productivity can be raised and economic vigor maintained. To do this, Japan must drastically change its economic structure into one led by more value-added sectors, while actively seeking to promote service industries that suit the needs of an aged society. To accomplish this shift with speed, Japan must continue reforming its economic structure, while inviting to Japan capital as well as the best ideas, know-how and human resources the world has to offer. Through this, Japanese business people and companies will be stimulated by the ensuing competition, causing Japan to transform itself into a new economic society. This is by far one of the greatest challenges facing Japan today.
Prime Minister Koizumi in his “Program to Double Japan-bound Investment” outlined this basic objective. In order for reforms to take hold, every system in Japan must naturally be made more open. To date, Japan has come a long way in making economic systems more open, in both nominal and real terms, as a result of structural reforms conducted since 1996: i.e. deregulation in sectors like distribution, major structural and financial reform (i.e., the financial Big Bang), the termination of lifetime employment and the adoption of international accounting standards.

In the 1980s, European and American business people saw Japan as very closed. While that attitude has been almost completely erased in the 21st century, I believe that Japan needs a second wave of restructuring to open the country further, with the ultimate aim of making Japan a more comfortable and welcoming environment for foreigners.

As economic integration in East Asia progresses and China continues on its rapid development, more and more Chinese companies are expected to enter the Japanese market. We wholeheartedly welcome this, as I believe such a presence will go far in helping Japan change.

**JETRO’s Roles**

I would like to sum up by talking about the roles JETRO is playing to accelerate bilateral (China-Japan) and trilateral (China-Korea-Japan) business alliances.

First of all, by fully mobilizing staff in our 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 points relating to local operations, including labor, legal aspects, taxation and intellectual property. As I mentioned earlier, we have been holding trade fairs for parts and materials throughout China, which are meant to serve the needs of both Japanese affiliates who want to increase their local procurement and Chinese local parts/materials suppliers who wish to develop business with Japanese affiliates. I again earnestly ask for the support of relevant Chinese authorities to make the Qingdao trade fair I proposed a reality.

Secondly, JETRO plans to offer further assistance to Chinese, Korean and other foreign companies planning to invest in or export to 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. At IBSC, foreign business people can 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, especially those in Qingdao and Shandong Province, will advance into the Japanese market and actively utilize JETRO’s IBSC (our Tokyo IBSC alone boasts more than 30 private office spaces that can be used for 2 months free of charge). And we now have four IBSC in other major cities throughout Japan, namely, Osaka, Yokohama, Nagoya and Kobe; our sixth Japan office is scheduled to open in Fukuoka in October 2004.

The third area in which JETRO can play a role is by working to expand and strengthen Japan-China business alliances. As I already mentioned, 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 already introduced. JETRO can also offer assistance in sharing technologies relating to energy and environmental protection, and provide various types of assistance in improving China’s investment climate, on the basis of opinions gathered from Japanese companies.

Fourthly, JETRO operates the Institute of Developing Economies (IDE), an organization internationally reputed for its comprehensive research and surveys on a host of issues related to 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 impact on trade and investment in East Asia as a whole, should be conducted. Actually, IDE and the Chinese Academy of Social Sciences have recently started a joint study on this topic. I believe an East Asia free business zone will start to become a reality faster than most are anticipating.

Conclusion

I have spoken about economic integration in East Asia and the Japan-China-ROK business alliance. 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, China and ROK 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, we will overcome any past histories, and proceed hand in hand in transforming East Asia into one prosperous economic zone. Together, Japan, China and ROK 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 the three countries will join forces so that East Asia may become a community that not only produces products, but also creates new intellectual property—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.