

# RECENT DEVELOPMENTS IN SINO-JAPANESE TRADE

MASAYA TSUCHIYA\*

## INTRODUCTION

Trade between Japan and the People's Republic of China commenced in 1950, though commercial relations fluctuated greatly for a decade thereafter, reflecting the instability of political relations between the two countries. As China's relationship with the Soviet Union, a major trading partner, deteriorated in the late 1950's, Chinese planners began to increase trade with non-communist nations. This led to the advent of the "friendly trade"<sup>1</sup> between Japan and China in 1960, which was formalized by Liao and Takasaki in a Memorandum in late 1962. That Memorandum initiated a period of stable expansion of Sino-Japanese trade, which has been interrupted only once—by the 1966 Cultural Revolution. Since the end of the Cultural Revolution, trade between the two countries has increased steadily.

In 1972, the total amount of Sino-Japanese trade reached a record high of \$1.1 billion<sup>2</sup> including both imports and exports, an increase of 22 per cent over 1971. China imported Japanese goods worth \$608,921,000, an increase of 5.3 per cent over the preceding year, while Japanese imports from China totaled \$491,116,000, an increase of 52 per cent. The excess of Japanese exports over imports, which has existed since 1965, has gradually decreased from a high of \$315 million in 1970, to \$255 million in 1971, and to \$118 million in 1972. In spite of its expansion, Sino-Japanese trade comprised only 2.1 per cent of Japan's total foreign trade for 1972. Japan's trade with other countries has expanded even more rapidly than its trade with China.<sup>3</sup>

The Sino-Japanese trade in the first half of 1973 again increased significantly following the resumption of diplomatic relations between Japan and the People's

\*Research Associate, Japan External Trade Organization (JETRO).

<sup>1</sup> A discussion of "friendly trade" appears in the text at p. 241.

<sup>2</sup> Unless otherwise noted, all amounts are expressed in American dollars.

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## PROGRESS OF SINO-JAPANESE TRADE

(Unit: \$1,000)

Year	Japanese Exports to China	Percentage of Total Japanese Exports (%)	Japanese Imports from China	Percentage of Total Japanese Imports (%)
1955	\$ 28,547	1.40	\$ 80,778	3.30
1960	2,726	0.06	20,729	0.50
1965	245,036	2.90	224,705	2.80
1969	390,803	2.40	234,540	1.60
1970	568,878	2.90	253,818	1.30
1971	578,188	2.40	323,172	1.60
1972	608,921	2.10	491,116	2.10

Compiled by the Japanese Ministry of Finance. For a complete listing of trade values for 1960 through 1966, see L. LEE, CHINA AND INTERNATIONAL AGREEMENTS 69 (1969).

Republic of China in September, 1972. Japan's exports to China in the first half of 1973 totaled \$472,660,000, an increase of 55.3 per cent over the same period in the preceding year, and imports totaled \$398,830,000, up 81.4 per cent. The export of steel, chemicals, machinery, and tools occupied more than 90 per cent of the export from Japan in this period. The import of textiles almost doubled over the first half of 1972, occupying 49 per cent of the total import. The import of coal to Japan increased 2.6 times, and the import of petroleum was commenced, though initially in a small quantity.<sup>4</sup>

## I

## THE STRUCTURE OF SINO-JAPANESE TRADE

As formal diplomatic relations between Japan and the People's Republic of China are a relatively recent development, Sino-Japanese trade has been conducted in a number of different ways. From 1950 to 1958, trade was conducted by private companies which entered into agreements for the exchange of goods. These agreements caused a steady increase in trade between the two countries, but the advances were not lasting. Increasing diplomatic and political pressures from Taiwan as well as the United States led to a more hostile attitude in Japan toward the People's Republic, culminating in China's suspension of all trade with Japan in 1958. The first significant structural arrangement developed two years later.

## A. Friendly Trade

In August of 1960, Premier Chou En-lai of the People's Republic of China proposed three political principles or prerequisites for trade.<sup>5</sup> The Japanese were not to: (1) obstruct the establishment of diplomatic relations between

## EXPORT AND IMPORT OF PRINCIPAL GOODS

(Unit: \$1,000)

Product	Japanese Exports		Product	Japanese Imports	
	1972	1st Half 1973		1972	1st Half 1973
Textiles	\$ 45,902	\$ 27,577	Foodstuffs	\$122,522	\$ 63,898
Chemical fertilizers	119,761	70,912	Textiles and textile goods	197,184	195,556
Synthetic plastics	26,488	14,564	Raw silk	114,902	97,833
Steel	244,728	242,430	Clothing	18,043	17,599
Machinery and tools	78,819	69,791	Silk fabrics	15,797	25,584
Bearings	11,478	10,442	Soybeans	37,963	22,239
Metal processing machines	6,477	3,481	Coal	5,396	3,701
Automobiles	17,612	12,869	Petroleum	—	1,622

Compiled by the Japanese Ministry of Finance.

<sup>5</sup> 3 JIH-PEN WEN-T'I WEN-CHIEN HUI-PIEN (COLLECTED DOCUMENTS ON JAPANESE PROBLEMS) 213 (1958).

Japan and the People's Republic of China; (2) participate in the formation of two Chinas; or (3) regard the People's Republic of China as an enemy. In an accompanying statement, Chou En-lai stated that it would be possible to conclude private foreign trade contracts even before the reinstatement of diplomatic relations between Japan and the People's Republic if both countries would display a friendly spirit. When Japanese businessmen accepted Chou's proposal, "friendly trade" was begun.

The Japanese enterprises participating in friendly trade had to be recognized as friendly enterprises by the People's Republic of China. In order to be designated "friendly," a Japanese enterprise had to declare that it would strictly observe (1) Chou's three principles, (2) the rule of inseparability of politics and economics, and (3) after April, 1970, Premier Chou En-lai's "Four Conditions."<sup>6</sup> Japanese enterprises which accepted these principles and conditions could be officially designated as friendly firms or enterprises by the China Council for the Promotion of International Trade or the Japan-China Friendship Association of China at the recommendation of friendship groups in Japan, such as the Association for the Promotion of International Trade or the Headquarters of the Japan-China Friendly Association.

With normalization of diplomatic relations between Japan and China on September 29, 1972, the basic spirit of these principles and conditions were included in the Japan-China Joint Declaration. After March 7, 1973, a Japanese enterprise desiring to participate in Sino-Japanese trade could do so simply by informing the Chinese that it accepted the spirit of the Joint Declaration. Such friendly trade comprises approximately ninety per cent of current Sino-Japanese trade.

#### B. The Liao-Takasaki Memorandum

In September, 1962, the late Mr. Kenzo Matsumura, a member of the Japanese Diet, and Premier Chou En-lai agreed that because the prospects for early signing of a Sino-Japanese trade agreement were dim, an interim arrangement was necessary to promote trade between the two countries. Pursuant to that agreement, the late Mr. Tatsunosuke Takasaki of Japan and Mr. Liao Cheng-chih of China signed a Memorandum two months later setting forth a five-year plan for Sino-Japanese trade. Expected total amounts of trade per year were established, as were the major products each nation would export.<sup>7</sup> Based on this Memorandum, the Chinese established a liaison office in Tokyo in September, 1964, and a Japanese office opened in Peking in January, 1965.

Since 1968, memorandum trade agreements have been concluded each year between the trade offices of each country. Annually a plan is agreed upon, which includes specification of principal goods for export and import. Japanese

<sup>6</sup> The Four Conditions indicate that the People's Republic of China will not trade with Japanese enterprises which (1) support Chiang Kai-Shek and Park Chung Hee, (2) invest heavily in Taiwan or South Korea, (3) participate in the United States invasion of Indochina, or (4) are Japanese-American joint-venture enterprises or subsidiaries of United States enterprises in Japan.

<sup>7</sup> 4 JIH-PEN WEN-T'I WEN-CHIEN HUI-PIEN (COLLECTED DOCUMENTS ON JAPANESE PROBLEMS) 90 (1963).

interests are coordinated by the Japan-China Trade General Liaison Council, a business organization which has organized councils for specific goods classified by commodity. Japanese enterprises desiring to participate in this trade are required to join the relevant council.

### C. Japan-China Trade Agreement

Mr. Chi Yeh-Shao, an official of the Ministry of External Trade of the People's Republic of China, came to Japan on August 16, 1973, to negotiate with the Japanese government for the formulation of the first trade agreement between the countries. The governments arrived at mutual agreement on the following points: (1) most-favored-nation status concerning customs, customs facilities, handling of merchandise for export and import, inland customs, and so forth; (2) the goods which the countries are mutually interested in trading and the quantity of import and export for each item; (3) yen or yuan or other currency of payment having convertibility; (4) international market prices as the basis of trade; (5) an annual committee meeting to be held between the Japanese government and the government of the People's Republic; and (6) a term of three years, renewable every year thereafter.

The Japan-China Trade Agreement was signed on January 5, 1974, incorporating these points and superseding the memorandum agreements negotiated annually since 1968. Henceforth, Sino-Japanese trade will be carried out in two forms: friendly trade and trade based on the list of materials for import and export set forth in the Japan-China Trade Agreement.

## III

### CURRENT TRADE BETWEEN JAPAN AND CHINA

#### A. Negotiation of a Contract

Sino-Japanese trade can be divided into two categories according to the form and the place of negotiations, namely the Canton Fair and Peking negotiations. In addition, more "Tokyo negotiations" have been conducted recently, with Chinese teams coming to Japan to participate.

Unlike trading with the capitalist countries, it is difficult to get concrete responses to inquiries when trading with China. Particularly in the case of exports to China, reactions to offers are slow and it is almost impossible to sign an export contract for any commodity not included in the Chinese import plan. Accordingly, Japanese enterprises attempt to fully inform state-run Chinese trade corporations of Japanese products by providing catalogs, pamphlets, and other information. Japanese enterprises also must participate in negotiations at the Canton Fair and in the exhibitions of Japanese goods held in China. Finally, it is often necessary to make use of other opportunities—such as the interchange of technical missions—in order to provoke a response.

#### 1. *Canton Fair*

The Canton Fair was first held in 1957 under the auspices of the China

Council for the Promotion of International Trade with the objective of exporting Chinese products to the overseas Chinese living in Hong Kong, Macao, Singapore, and other Southeast Asian countries. At present, negotiations for both exports and imports are made under the auspices of the Chinese state-run trade corporations. Participants come from all parts of the world. The Canton Fair is held twice a year, once in the spring (April 15th to May 15th) and again in the autumn (October 15th to November 15th).<sup>8</sup> The contracts negotiated at the Canton Fair amount to about forty per cent of the total of China's foreign trade.

Japan has participated in the Canton Fair since 1961. Applications for participation from the Japanese friendly firms are collected by the Association for the Promotion of International Trade of Japan and are submitted to the Chinese. Invitations are sent to the friendly firms by the China Council for the Promotion of International Trade. Trading firms which receive invitations often retain production firms to assist in the negotiations at the Fair. This allows Japanese trading firms to use the superior technical knowledge of producing industries without committing the resources necessary to develop expertise regarding each individual product.

Once a contact is made at the Fair, the Japanese firm makes concrete offers for the export or import of items in compliance with its trading plan. The Japanese firm then must wait for an appointment to begin negotiations. When negotiations begin, China is represented by members of the state-run trade corporation handling the commodity under discussion. On the Japanese side, generally the manufacturer or the intended consumer handles the negotiations, as they possess the necessary technical knowledge. They are assisted by the trading firm with which they are associated. If the transaction is large and the negotiations successful, the Chinese may make allotments among several of the Japanese trading firms. After any such allotment, a contract is signed by the Japanese trading firms and the Chinese trade corporation involved.<sup>9</sup>

Generally, negotiations for Chinese export to Japan occur during the first half of each session of the Canton Fair and negotiations for Japanese export to China during the latter half. In many cases the contracts cannot be signed during the session, and additional negotiations are carried on in Peking.

## 2. *Peking Negotiations*

When complex machinery or large quantities of materials are being considered for trade, the parties often do not limit negotiations to the periods during the Canton Fair. This is especially true when China desires to import substantial amounts of machinery, plants, iron, steel, fertilizers, and similar products from Japan. The process normally begins with a specific written inquiry by the Chinese, covering specifications, quantities, and other necessary details, except the date of delivery and price. The Japanese trading firms may make counteroffers by letter or telegram, but generally the complexity of the

<sup>8</sup> Canton is now officially known by the Chinese as Kwangchow.

<sup>9</sup> The other party to a contract for Sino-Japanese trade is always the Peking head office of the state-run trade corporation.

matters necessitate the dispatch of negotiating teams to Peking. Hence these business talks are termed "Peking negotiations." As at the Canton Fair, the Japanese negotiating effort is generally headed by technical experts from manufacturing or producing enterprises, with officials of the trading firms acting in a supportive capacity. When negotiations are concluded, a protocol is exchanged, and after any necessary allotments are made to the various Japanese trading firms, contracts are signed by the trading firms and the Chinese trade corporations. Because of the extent of recent trade, there are now about fifty employees of Japanese enterprises permanently stationed in Peking for such negotiations.

### B. Trade Control

With the signing of the Japan-China Trade Agreement, the parties granted reciprocal most-favored-nation status, thus eliminating the discriminatory tariffs both nations had maintained. The People's Republic of China will reduce the import tariff on items from Japan from the normal rate to the minimum rate, a reduction of approximately one-third. Prior to the Trade Agreement, Japan was applying its statutory rate to imports from China, but the most-favored-nation status invokes the GATT conventional rate which is half the statutory rate. Japan, however, has a list of some thirty-two products, including agricultural products, hides and leather, and computers, the import of which is forbidden, and this policy will apply to China as well as all other trading nations. In addition, the import of meat from China, particularly beef and pork, is prohibited at present because of hoof-and-mouth disease. Finally, Japanese trade is presently also subject to some control from the International Coordinating Committee on Strategic Trade with Communist Countries (COCOM), a group formed by Japan and the Western nations to regulate trade with the communist bloc nations.

### C. Payments

Trade negotiations between Japan and China had to be suspended when the floating exchange rate system was adopted for the British pound in June, 1972, because the British pound was the main currency used for payment in Sino-Japanese trade. In response, the Yen-Yuan Settlement was adopted between Japan and China in August, 1972. But this payment arrangement was far from perfect, as it was adversely affected by the recent dollar devaluation and the dollar sales for Deutsche marks in Europe. Therefore, Japan (through the Bank of Tokyo) and China (through the Bank of China) revised the Yen-Yuan Settlement agreement in August, 1973.

The main points of this argument are as follows. (1) The Japanese yen and the Chinese yuan shall be added to the British pound and the French franc as payment currencies in Sino-Japanese trade. The importing party shall have the option of choosing the currency in which payment is to be made.<sup>10</sup> (2) The

<sup>10</sup> Although the choice of payment currency is theoretically the option of the importer, Chinese imports from Japan are entirely quoted in yuan and Japanese imports from China are, in substance, quoted in yuan in eighty to ninety per cent of the transactions because yuan credits are used.

yen-yuan exchange rate shall be quoted by the Bank of China according to the market rate. (3) The Bank of China shall open a yen deposit account in the Foreign Exchange Bank of Japan, and the latter a yuan deposit account in the Bank of China. All yen-yuan transactions involved in Sino-Japanese trade shall be conducted through these accounts. (4) The yen balance held by the Bank of China and the yuan balance held by the Foreign Exchange Bank of Japan shall be converted into British pounds and be drafted or transferred into a fixed deposit. Thereafter, the conversion from the yuan to the pound and the conversion from the yen to the pound shall be effected at the market rate. The balance in the yuan account can be used only for trade settlement between Japan and China and may not be used for payment abroad; it may, however, be transferred among foreign exchange banks of Japan within Japan. The initial term of this agreement was for one year, but it is renewable annually.

Japan enjoyed a surplus of some \$118 million in her trade with China in 1972, and thus the yuan deposit of the Foreign Exchange Bank of Japan in the Bank of China has increased significantly. In the negotiations leading to the Yen-Yuan Settlement, the Japanese hoped to have their yuan holdings convertible into yen, but China feared the risk of dealing with the strong yen and consequently the agreement adopted the formula of payment in the British pound. As a result, while the yen has grown stronger in relation to the pound, the conversion rate of yuan to the pound has not risen in proportion.

Another problem is that the conversion rates of the yuan to other currencies are set unilaterally by the Bank of China, and it is uncertain on what basis these rates are fixed. Nevertheless, judging from the rates quoted by the Bank of China following the Smithsonian Agreement,<sup>11</sup> the floating of the British pound, and the latest devaluation of the American dollar, the yuan was listed below only the yen, the mark, and the Swiss franc in strength, and is subject to relatively little risk from the pound or dollar.

#### D. Plant Exports

Prior to the establishment of diplomatic relations with China, the Japanese government had not decided whether to permit the Export-Import Bank of Japan to finance the import of plants by China. A prime reason for Japan's reluctance was the desire to support the government of Taiwan. For example, in August, 1963, the Ministry of International Trade and Industry approved the financing by the Export-Import Bank for exports of a vinylon plant of Kurashiki Rayon Co., Ltd. to China, but the Sato Cabinet disapproved the plan in 1965. This disapproval was based on a letter from former Prime Minister Yoshida to the Nationalist Government of Taiwan which stated that Japan would not approve plant exports to the People's Republic of China which involved deferred payments. However, with the resumption of full diplomatic relations between Japan and China, a contract for the export of an ethylene manufacturing plant to China with financing provided by the Export-Import Bank was signed in December, 1972. Subsequently, many such plant

<sup>11</sup> 66 DEP'T STATE BULL. 32 (1972).

export contracts have been concluded on the basis of Export-Import Bank financing.

As China is now striving for development of a petrochemical industry, Japan's plant exports have primarily been in that field. In addition, China is now expanding and modernizing its iron and steel industry, developing an electronic industry, and improving the transportation network. Accordingly, the Japan Steel Corporation and Kawasaki Steel Corporation are currently negotiating for the export of large iron and steel plants. In addition, various types of ships are being exported, and negotiations for other kinds of plant exports are in progress. China's import of plants alone from the Western countries in the next few years is expected to exceed \$2 billion.

One potential problem in the export of plants is that China is not a signatory to the Paris Treaty which assures international protection of industrial property. In China all inventions by an individual revert to the state.

#### E. Technical Cooperation

The Canton Fair is a commodity exchange, but at the same time it is an important place for the exchange of technology. Technical cooperation between Japan and China began at the time the protocol concerning friendly trade was signed in 1962. This technical cooperation was interrupted by the Great Cultural Revolution, but was resumed at the Canton Fair in the spring of 1970. At the Fair, the interchange of ideas generally takes the form of an orientation given by the Japanese manufacturer to the Chinese party importing the item. Normally only the representatives of the Chinese trade corporations are involved in these interchanges; but occasionally the end consumers of the product become involved, thus giving the Japanese an opportunity to get an actual "feel" for the people of China.

The Canton Fair is not the only time an exchange of technology occurs; trade fairs opened in China by other countries are also important. In 1973, Japan held an Exhibition of Japanese Automated Electronic and Medical Equipment. This fair was sponsored by the Association for the Promotion of International Trade of Japan and lasted for two weeks. At this fair the forty-two Japanese firms participating held more than four hundred meetings with the Chinese, thus providing a great opportunity for an exchange of information.

Finally, economic and trade missions from Japan and China have frequently traveled between the two countries since the establishment of diplomatic relations. As yet, however, no agreement for scientific and technical cooperation between Japan and China has been concluded, and a joint committee for scientific and technical interchange has not been organized.

#### CONCLUSION

The major obstacle to the expansion of Sino-Japanese trade was removed by the establishment of diplomatic relations in 1972. The mutual extension of most-favored-nation status by the 1974 Japan-China Trade Agreement should also serve as a stimulus. Thus it appears that the prospect for expansion of trade between Japan and China is bright.

One potential problem remains, however—the imbalance in the amount of goods exported by each nation. As indicated above, the excess of Japanese exports to China over Chinese exports to Japan has decreased gradually in the past few years. However, as Japan's exports of plants, iron, and steel continue to increase, the Japanese must augment their imports in order to reach a trade equilibrium. Japan now imports fish products, peanuts, fruits, soybeans, raw silk, rosin, hog hair, and other natural products from China. While demand for such natural products in Japan will continue to increase, it is obviously not unlimited. Some hope lies in further expansion of Chinese exportation of petroleum, coal, iron ore, and nonferrous metals, but the demand for crude oil in China is also increasing rapidly. For these reasons, China is counting heavily on the export of processed goods to Japan to balance its trade deficit. The export of Chinese silk fabrics and clothing to Japan is increasing, and it is anticipated that the Japanese demand for Chinese furniture, shoes, sundries, ceramic ware, and fittings will also increase. Perhaps the happiest solution for the near future would be the development of regional specialization, with Japan operating heavy and chemical industries, while China specializes in various light industries.