

## Decreasing Dependence of Japanese-affiliated Manufacturers in China on Third Countries

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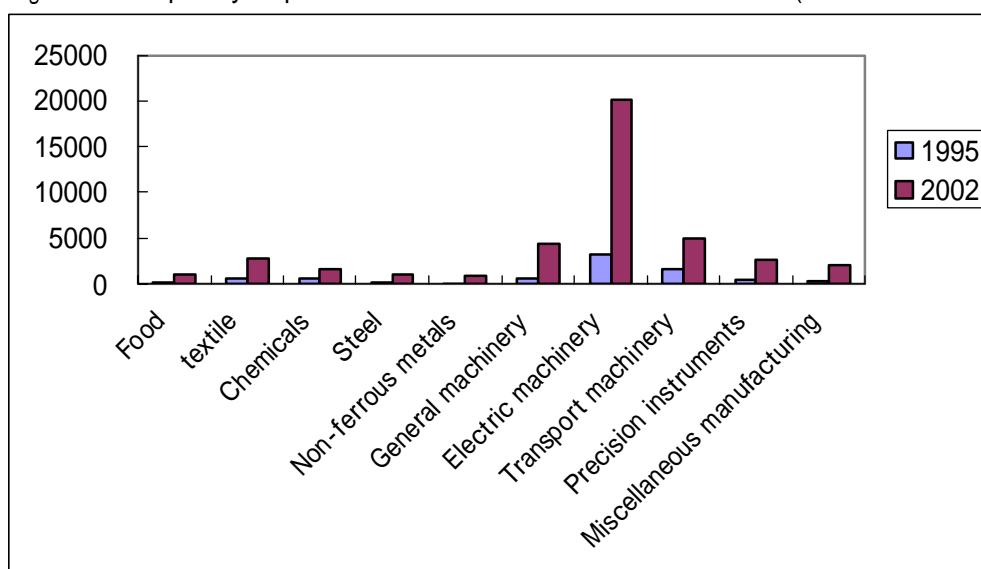
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By means of an input-output table that explicitly separates Japanese affiliates in China from the domestic Chinese economy and treats them as an independent regional economy, this report analyzes changes in activity levels of these Japanese corporations and their relationships with other economic entities.

Based on data and analyses including Asian International Input-Output Table 1995 by the Institute of Developing Economies (IDE), SNA Input-Output Table by the Cabinet Office and Basic Surveys on Overseas Business Activities by the Ministry of Economy, Trade and Industry (METI), a quasi-interregional input-output model among three regions, i.e. domestic Japan, Japanese affiliates in China and domestic China except the Japanese affiliates, has been constructed for years 1995 and 2002. The model divides the industrial sector into eighteen sub-sectors for respective regions, or a total of fifty-four. This report presents several interim results focusing on manufacturing industries, which should presumably be of utmost interest when analyzing economic activities of Japanese affiliates in China.

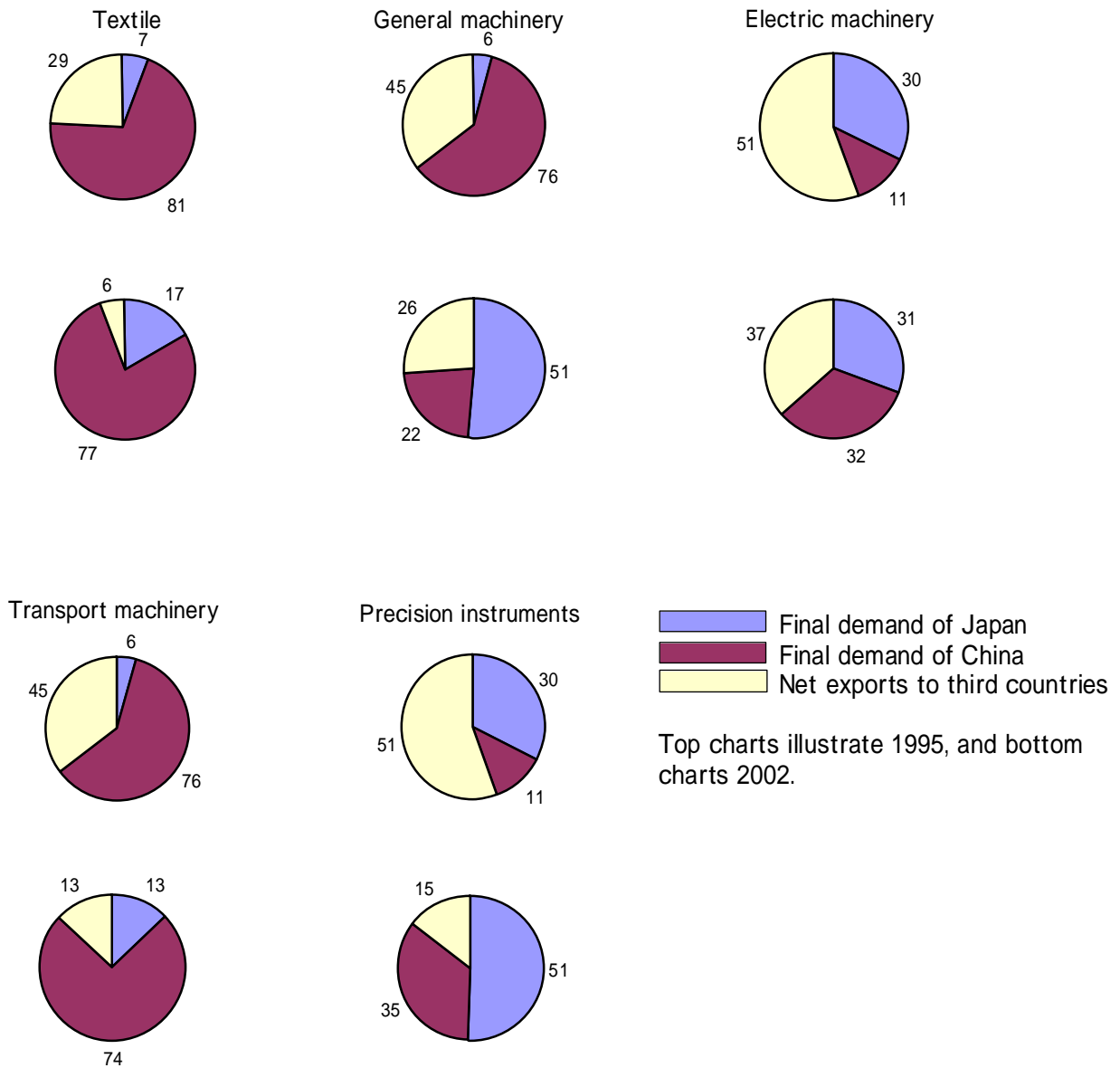
Figure 1 Output by Japanese-affiliated manufacturers in China (million US dollars)



The total output (sales) of Japanese-affiliated manufacturers in China has more than quintupled on a dollar basis over the seven-year period between the aforementioned years. (See Figure 1). The output has been dominated by electrical equipment, followed by other types of machinery. In 2002, the absolute amount of the total output was still approximately 2% of that of the domestic Japanese manufacturing sector, but the growth was phenomenal from a mere 0.2% in 1995.

An analysis of an input-output model reveals whose demand is driving the output of an industry. In our model, final demand is divided into demand from Japan, demand from China and net export to third countries, and the percentage of the output of respective industries attributable to each final demand category has been derived. (See Figure 2.)

Figure 2 Composition of output by regional demand



A majority of textile output continues to be supplied to the domestic Japanese market but supply to the domestic Chinese market has been growing in percentage terms. With respect to general machinery, net export to third countries has lost its share, while supply to the domestic Japanese and Chinese markets has seen their respective shares increase by approximately ten percentage points. Similarly, the ratio of electrical machinery output induced by export to third countries has been decreasing and the decline has been compensated by rising supply to the Japanese and Chinese markets.

Transportation machinery has traditionally been geared toward the domestic Chinese market, which takes in three-quarters of the output. The Japanese market, however, has recently been growing in relative importance. The precision instruments sector was once a typical industry where production in China substituted export from Japan, as seen in the fact that almost 60% of the output by Japanese transplants in 1995 was geared toward third-country export market. Recent data, however, show that demand in the Japanese and Chinese markets accounts for close to 90% of their production.

The above findings demonstrate that the growth pattern of Japanese-affiliated manufacturers in China is transitioning to one characterized by increasing supply to the domestic Japanese and Chinese markets from one led by promotion of third-country export.