Summary of the White Paper on International Economy and Trade 2018

- The global economy is now facing significant shifts, for example; movements against the free trade system under the WTO; advancement of digital transformation including expanding digital trade; and the rise of China and other emerging and developing economies.
- The White Paper 2017 focused on the first shift mentioned above, and analyzed the issues surrounding inequality in developed economies and relationships between trade and inequality. The White Paper 2018 focuses on the remaining two shifts.

1. Expanding digital trade

- The scale of the global cross-border e-commerce (EC) market was 236.0 billion dollars in 2014. It has continued to expand since then and is expected to reach 994.0 billion dollars in 2020. The number of cross-border EC users, which was around 300 million people in 2014, is expected to approximately triple to 900 million people in 2020.
- In line with the expansion of digital trade, the presence of global companies that provide IT platforms for EC and cloud computing services is increasing. In the global top 10 rankings in terms of market capitalization as of January 2018, six companies were IT platform companies from the United States and China.
- The free flow of information is developing a favorable cycle that is creating new technical innovations and business models and is improving the quality of people's lives. On the other hand, digital protectionism is also emerging over the past two decades, including data localization regulations that impede free cross-border data flow. Any introduction of new regulations restricting data is expected to negatively impact GDP.
- Other challenges include securing an environment of fair competition between IT platform providers and existing industries and ensuring the protection and safety of consumers.

2. Rise of emerging and developing economies

- Since around 2000, emerging and developing economies, and especially China, have led global economic growth. The global GDP share of emerging and developing economies is becoming around 40%.
- In emerging and developing economies, fixed capital formation has accelerated since around 2003, and in 2016, it reached almost the same value as in developed economies. In line with the growth in fixed capital formation, emerging and developing economies have significantly increased the production capacity of their raw materials industries.
- Looking at the steel industry in China as an example of the excess production capacity in emerging and developing economies, the process can be categorized into four chronological stages as follows. (i) as state-owned banks increased low-interest loans to steel companies and the companies expanded production capacity, the return on assets (ROA) rose; (ii) while domestic supply exceeded demand, loans and production capacity expansion of the companies continued, resulting in a decline in the ROA for steel companies; (iii) as steel companies reported losses, the

governmental subsidies increased steeply; and (iv) recently, the central government set reduced targets for production equipment and strictly managed the implementation of the target, and as a result, the target has been achieved.

- Sharp increases in capital investment through governmental support in China are also seen in the integrated circuit industry. There is a risk that an excess production capacity problem in the industry may occur in the future.

3. Rapid change in the Chinese economy

(1) Advance of new industries

- China is gradually shifting from investment-led to consumption-led growth. By industry, the information and communication and information technology services industries grew by 26% in 2017 compared with the previous year.
- China boasts the world's largest scale of e-commerce (EC) sales. The market scale of internet services for consumers and the sharing economy are rising at a high pace.
- Since around 2014, when "Mass Entrepreneurship and Innovation," an entrepreneurship support initiative promoted by the Chinese government, was announced, the number of new business startups has increased rapidly. The ratio of new businesses starting in China is significantly higher than those in the United States and Japan. In terms of the value of investments made by venture capital, China was the second largest investing country after the United States.
- Regarding China's innovation capacity, according to the number of international patent applications publicized in the 10 priority fields of "Made in China 2025," China has become a major global player particularly in the field of IT-related technology. On the other hand, China still lags behind the United States in the field of biotechnology and medical products, and behind Japan in the field of machinery, including robots.
- Looking at the supply of highly skilled human resources that support innovation and startups in China, of the more than 7 million students who graduate annually from universities in China, around 200,000 start a new business. Nearly half of Chinese students studying in the United States major in the STEM (science, technology, engineering and mathematics) fields. While the return rate of students studying abroad to China had been low, the Chinese government announced a series of measures to encourage such students to return to China, and as a result, the return rate rose to 85% in 2013.
- It is significant to recognize anew the advance of new industries, the improvement of innovation capability, and the state of vigorous entrepreneurship activity in China and to make further efforts to vitalize Japanese domestic industries.

(3) Expanding external trade and investment

- Countries for which China is the largest import source country have rapidly increased. In 2017, China was the largest source country for imports for around 30% of all countries around the world. China is also the largest export destination country for 16% of countries, the second-largest after the United States.

- Electrical and optical equipment have replaced textiles as the main driver of Chinese exports. The growth in the shares of China's electrical and optical equipment industry exports is higher on a value-added basis than on a customs-clearance basis. The domestic value-added ratio of the industry's exports is also growing, indicating progress in a shift to local procurement of parts and to products with higher value-added.
- China was the most frequent target of anti-dumping (AD) measures implemented against it. Emerging and developing economies implemented anti-dumping measures against China in more cases than advanced economies. In addition to implementing AD measures against China, the United States considered and implemented other trade measures with China based on Section 301 of the trade act and other laws. Europe has also implemented AD measures against China, and revised the AD regulation in 2017.
- Since the beginning of the 2010s, Chinese companies have become active in acquiring industrial and technology companies in advanced economies. The United States and European countries are moving to strengthen their regulations regarding foreign direct investment and operation thereof.

(4) Business opportunities for Japanese companies

- The value of Japanese exports to China reached a record high of around 14.9 trillion yen in 2017, making China the second-largest export destination country for Japan, after the United States. Exports of foods, consumer goods and industrial machinery (semiconductor-manufacturing equipment and machine tools) increased significantly. The value of cross-border EC purchases by Chinese consumers from Japan is rapidly growing as well.
- Between 2013 and 2017, per-capita consumption expenditure in China increased by around 40%. In particular, the shares of education, culture, leisure, health, and medical care expenditures in overall consumption increased.
- What is notable about Japanese companies operating in China is the large proportion of manufacturing companies. Japanese manufacturing companies are increasing both sales and profits by capturing robust domestic and external demand related to China. On the other hand, the Japanese service industry is lagging behind their European and U.S. competitors in China. There is further room for growth in Chinese consumer markets, including markets of products for the middle class, babies and infants, and elderly people.
- In China, addressing environmental problems has become a major challenge. While Japanese companies also need to comply with environmental regulations, this may create business opportunities for companies in possession of superior environmental technologies.
- It is crucial to take advantage of the vitality of China, which continues to grow, to vitalize Japanese industries through further business expansion of Japanese companies in China and cooperation between Japanese and Chinese companies in third-party countries.