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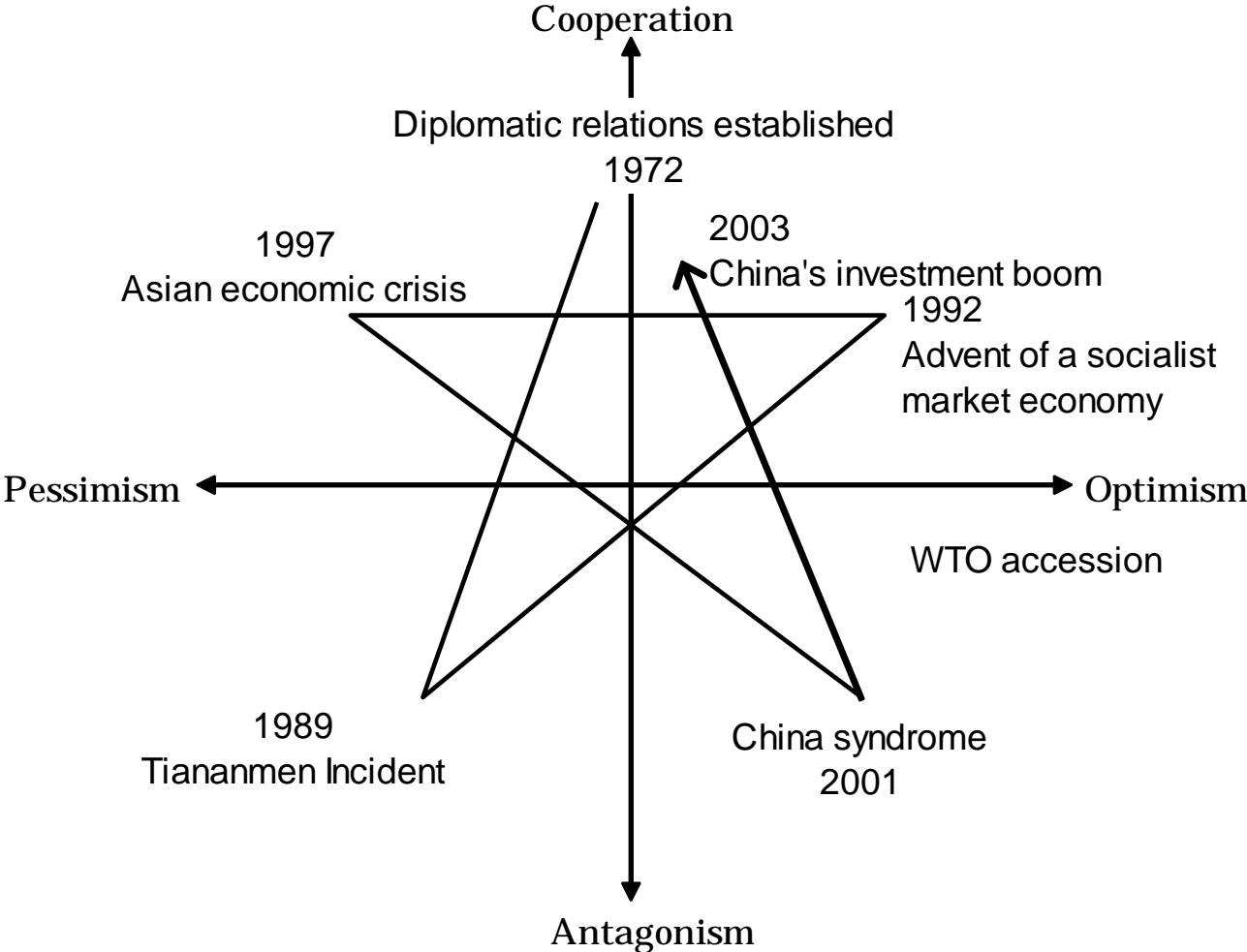
# The Rise of China: Challenges and Opportunities for Japan and the World

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<http://www.rieti.go.jp/en/china/index.html>

# Japan's Changing View of China



# Comparison between Major Development Indicators of China and Japan

	China (Latest)	Japan (Around 1960)
Life Expectancy (years)	71.4 (2000)	71.5 (1967)
Infant Mortality Rate (per thousand)	28.4 (2000)	28.6 (1961)
Primary Sector as a Share of GDP (%)	15.4 (2002)	14.9 (1960)
Engel's Coefficient (%)	37.7 (2002)	36.7 (1962)
Per Capita Electricity Consumption (kwh)	1158 (2001)	1236 (1960)

Source: Official Statistics of China and Japan.

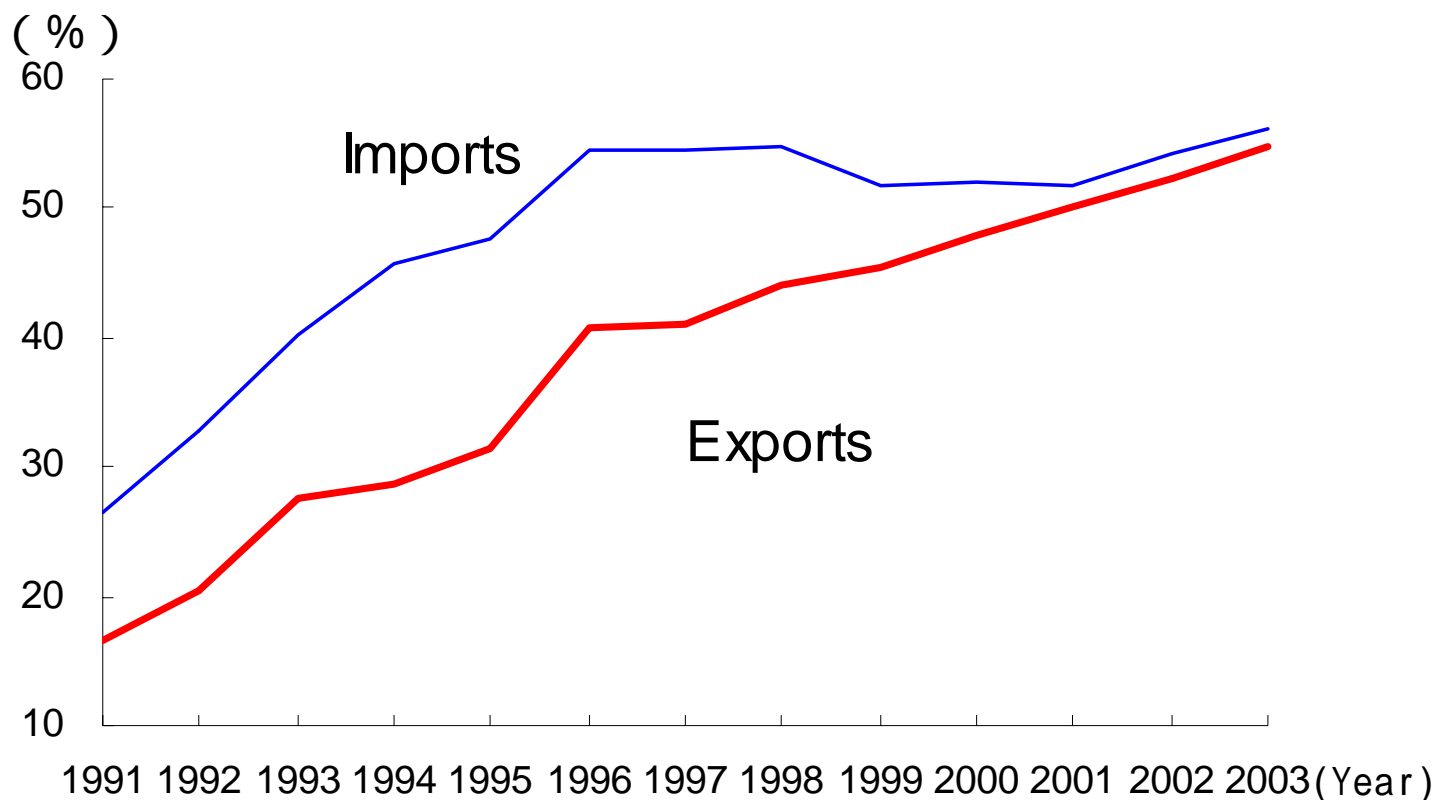
# Top Trading Nations in 2003

(US\$ billion)

Exports			Imports			Total		
Rank	Country	Amount	Rank	Country	Amount	Rank	Country	Amount
1	Germany	748.4	1	U.S.	1305.6	1	U.S.	2029.6
2	U.S.	724.0	2	Germany	601.7	2	Germany	1350.1
3	Japan	471.9	3	China	412.8	3	Japan	854.9
4	China	438.4	4	France	388.4	4	China	851.2
5	France	384.7	5	U.K.	388.3	5	France	773.1
6	U.K.	303.9	6	Japan	383.0	6	U.K.	692.2

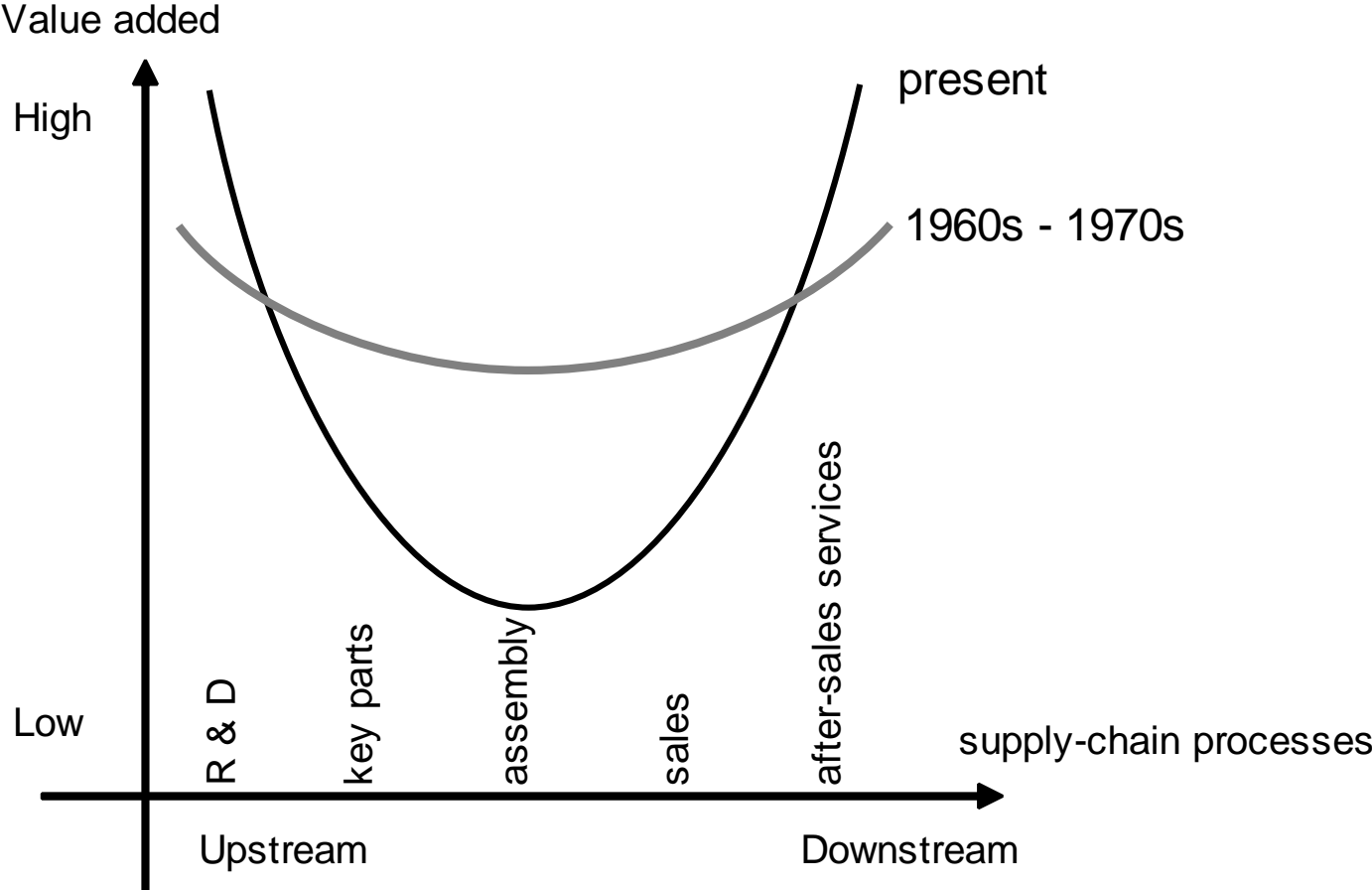
Source: WTO

# Share of Foreign Companies in China's International Trade

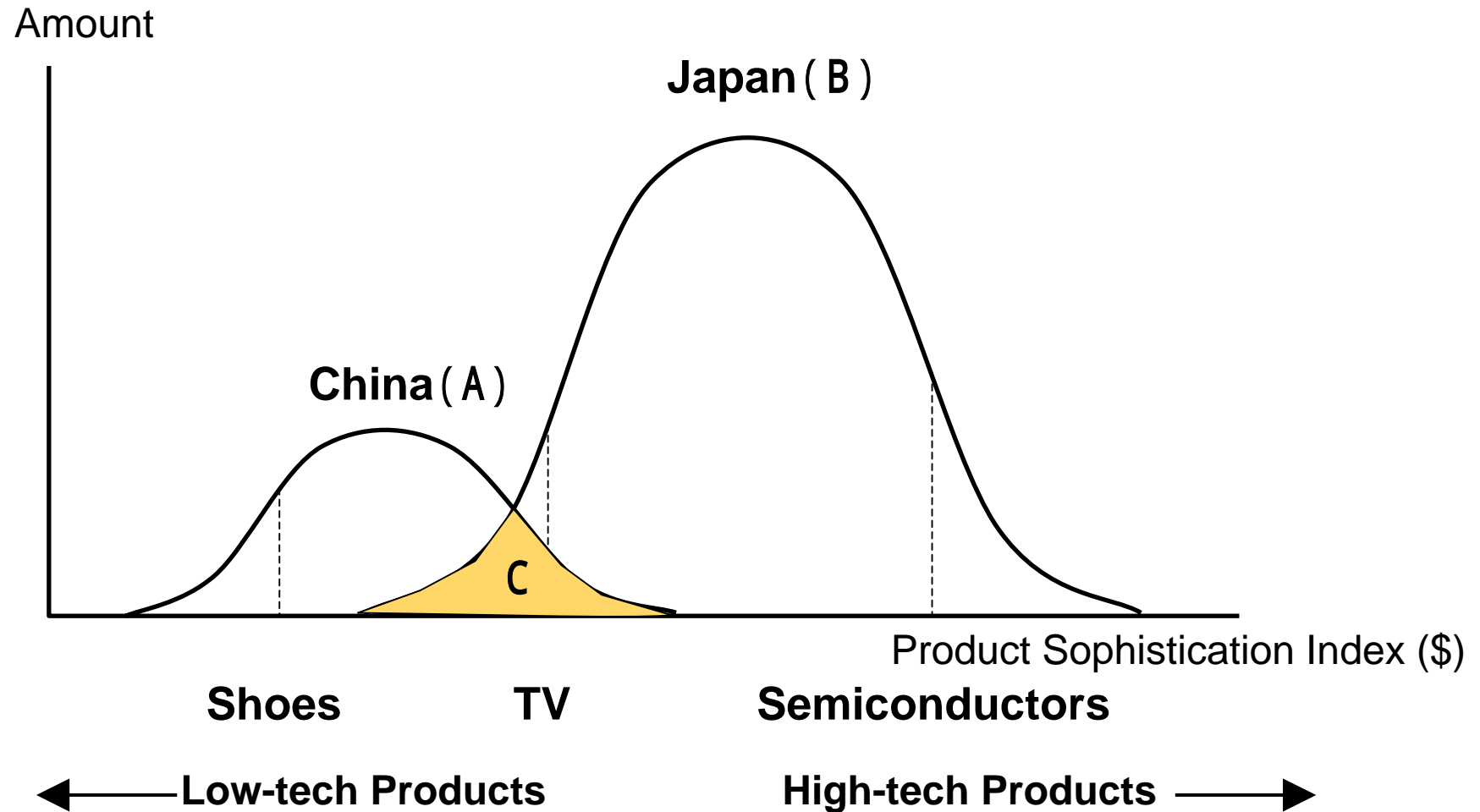


Source: China's Customs statistics.

# For Whom is the Smiling Curve Smiling?



# Competition between China and Japan



# Asian Countries' Competition with China

	1990	1995	2000	2003
Japan	3.0%	8.3%	16.3%	22.2%
South Korea	24.0%	27.1%	37.5%	40.6%
Taiwan	26.7%	38.7%	48.5%	68.7%
Hong Kong	42.5%	50.5%	55.9%	69.1%
Singapore	14.8%	19.2%	35.8%	46.8%
Indonesia	85.3%	85.5%	82.8%	83.3%
Malaysia	37.1%	38.9%	48.7%	68.0%
Philippines	46.3%	47.8%	46.1%	63.0%
Thailand	42.2%	56.3%	65.4%	79.8%



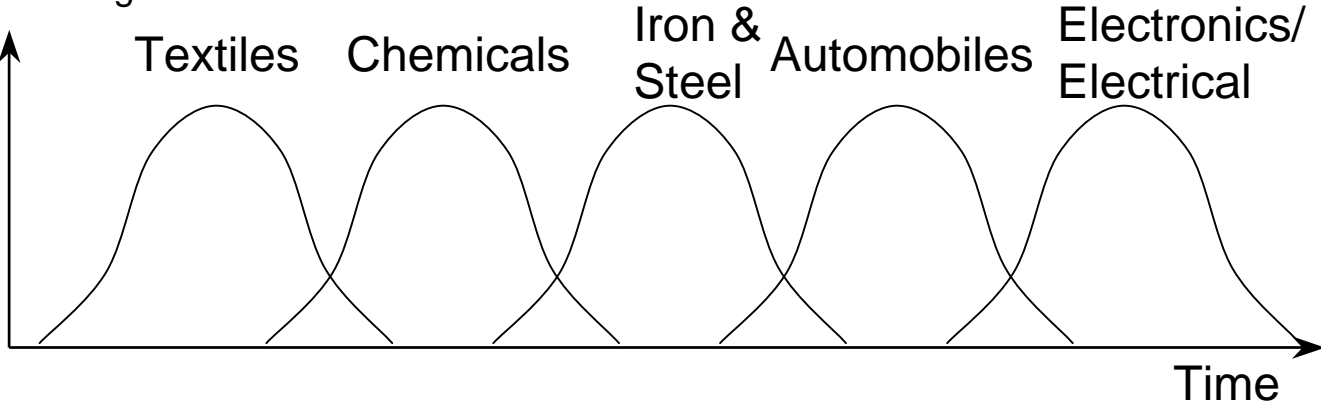
# Japan Competes Less than 10% with China

- Division of labor within each product category
  - Lower-end versus higher-end products
- High import content of Chinese products
- Japanese companies rely more heavily on FDI than on trade to access the U.S. market
- Actual degree of competition with China is about 10% for Japan

# Asia's "Flying Geese" Pattern of Economic Development

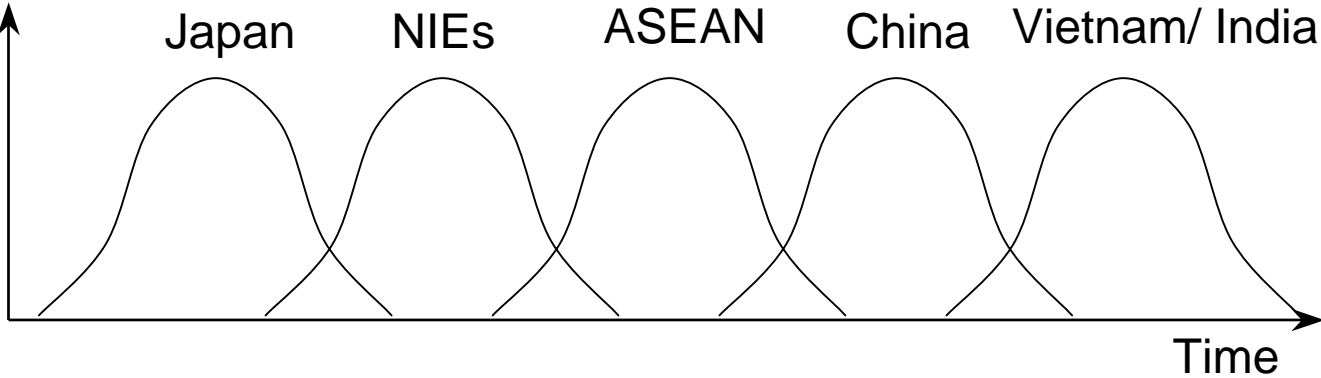
Indicator of Comparative Advantage

a) For a Particular Country

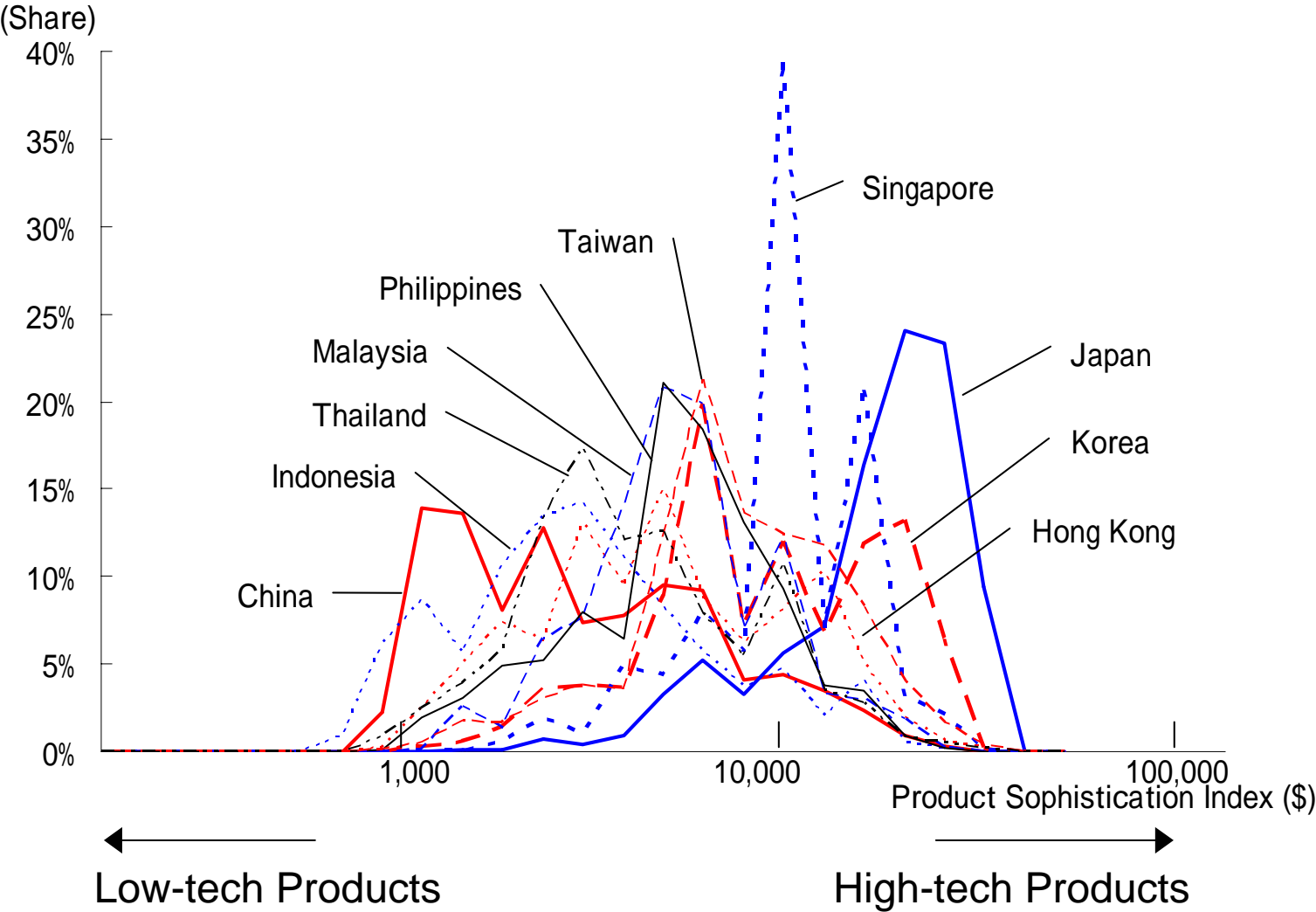


Indicator of Comparative Advantage

b) For a Particular Industry (e.g. textiles)



# The Flying Geese Pattern of Asian Countries Exports (In Terms of Exports to the United States, 2002)

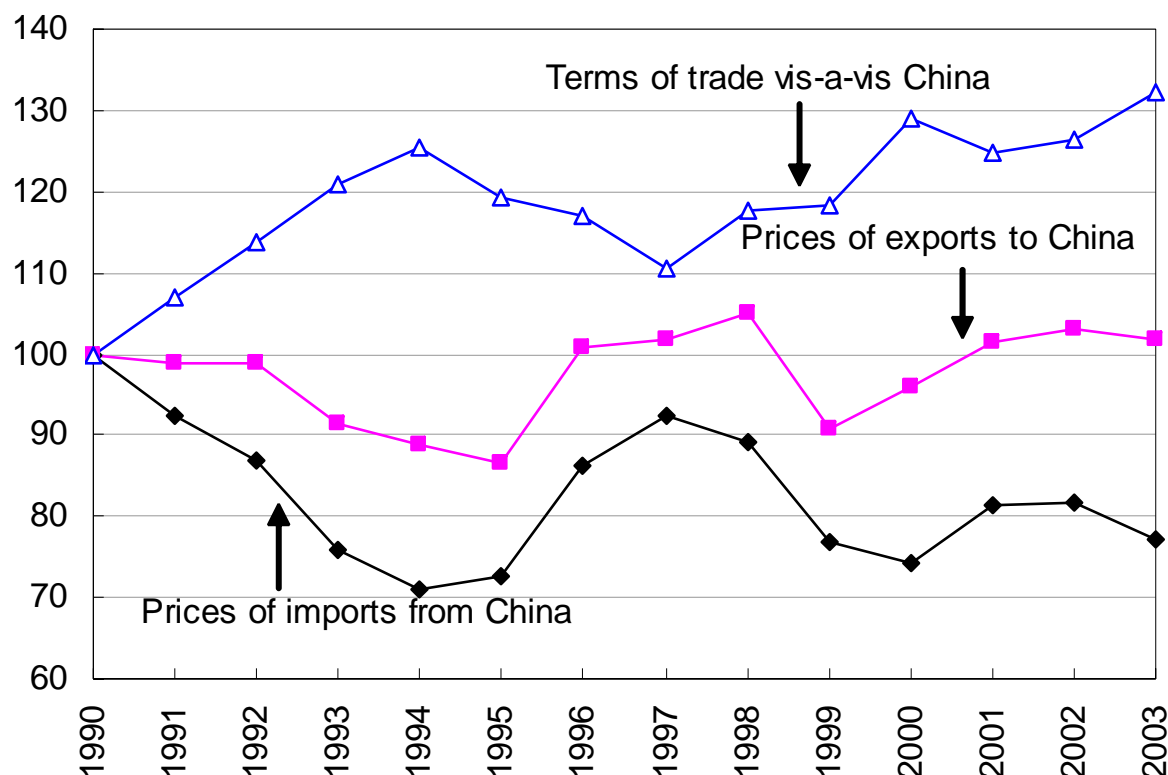


# The Rise of China and Changes in the Terms of Trade

- Reform and door opening: integration of China into the global economy according to comparative advantage
- Terms of trade = Export prices / Import prices
- China's TOT =  $\frac{\text{Prices of labor-intensive goods}}{\text{Prices of technology-intensive goods}}$
- China's TOT fall as exports expand – immiserizing growth
- TOT of ASEAN countries that compete with China fall
- TOT of Japan and NIEs, whose trade structures are complementary to that of China, rise

# The Improvement in Japan's Terms of Trade vis-a-vis China

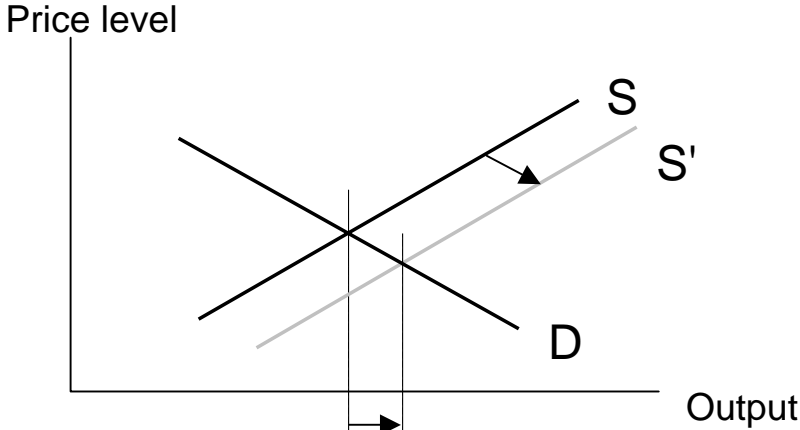
(1990 = 100)



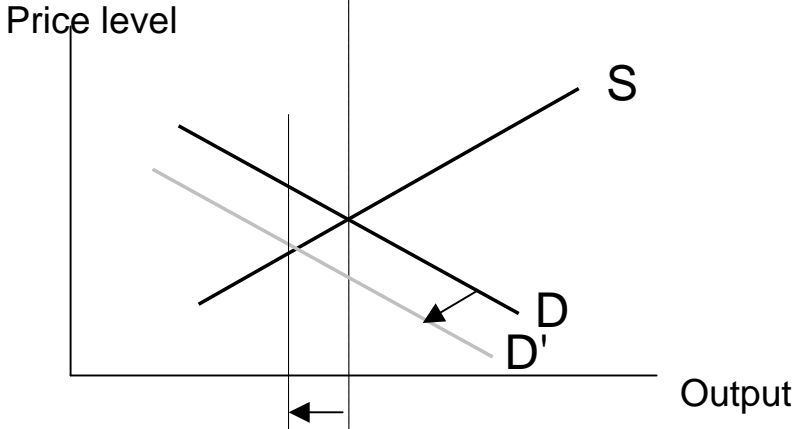
Source: Bank of Japan "Corporate Goods Price Index, Export and Import Prices."

# The China Factor in Japan's Deflation

Good Deflation:  
Lower import prices



Bad Deflation:  
Demand shift to Chinese products



# Effects of a Stronger Yuan on Japanese Companies

Positive (16%)	<p>A rise in exports to China can be expected</p> <p>The competitiveness of Chinese products will decline</p> <p>The value of our yuan holdings will rise</p>
More or less neutral (47%)	<p>The scale of our China-related business is small</p> <p>Our imports from and exports to China are balanced in value terms</p> <p>We have the ability to absorb currency rate fluctuations</p>
Negative (37%)	<p>Prices of imports from China will rise</p> <p>The competitiveness of our production facilities in China will decline</p> <p>The cost of Japanese staff in China will rise</p> <p>A strong yuan may have a dampening effect on the Chinese economy</p>

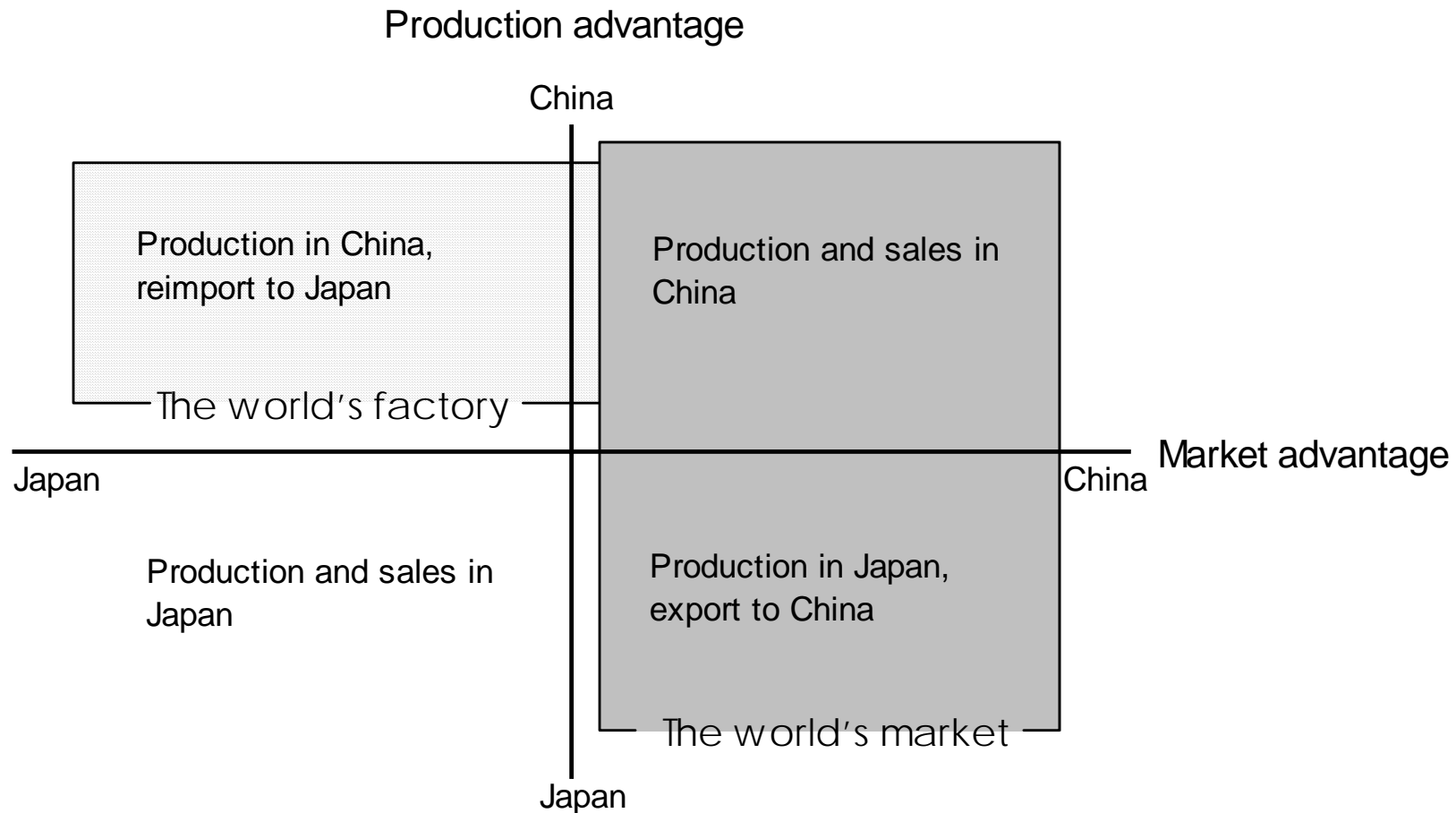
Source: Nihon Keizai Shimbun (Sept. 20, 2003)

# Coping with the Rise of China

- Positive attitude :
  - Speed up reform
  - Relocate declining industries overseas on the one hand, promote new industries on the other to achieve industrial upgrading without hollowing out
- Negative attitude :
  - Using China as a scapegoat to cover up mistakes
  - Lobbying for government protection



# Models of "China Business" for Japanese Firms



# Japanese Investment in China and the Hollowing-out Problem

- Japanese FDI in China was a mere \$3.1 billion in FY2003 (8.7% of Japan's overseas investment, or 0.06% of Japanese GDP)
- Good FDI
  - Cost reduction
  - Division of labor according to comparative advantage
  - Optimal allocation of resources
- Bad FDI
  - Need to circumvent trade barriers such as tariffs
  - Misallocation of resources
  - Cause of hollowing out

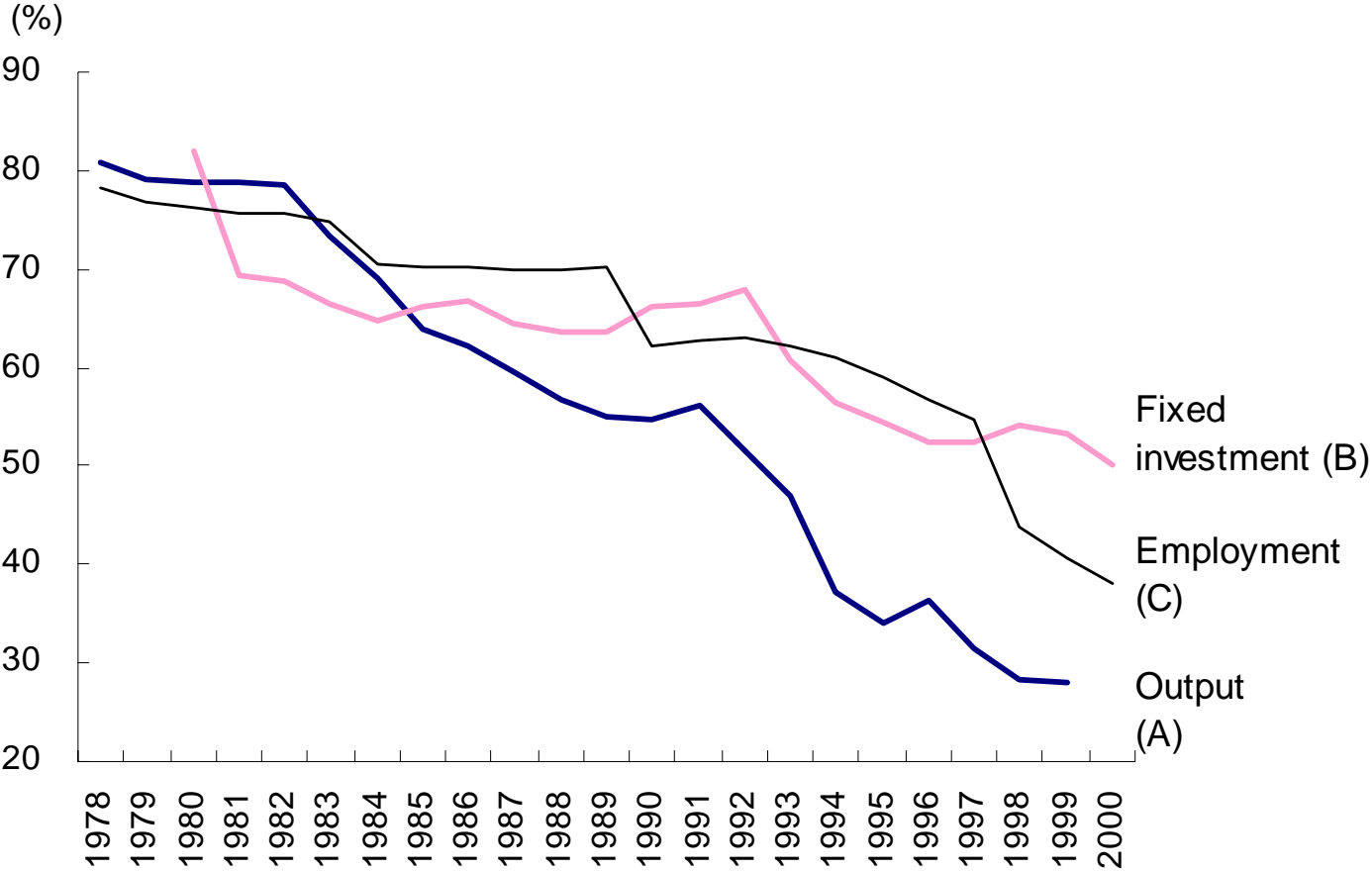
# Towards an FTA between Japan and China

- Japanese carmakers investing in China to avoid trade barriers and trade friction
- With an FTA, carmakers stay in Japan and access the Chinese market through exports
- As a result, new jobs (good jobs) are created at home
- FTA helps solve Japan's hollowing-out problem
- Japan and China should learn from Europe's experience in using economic integration as a means to overcome historic antagonism

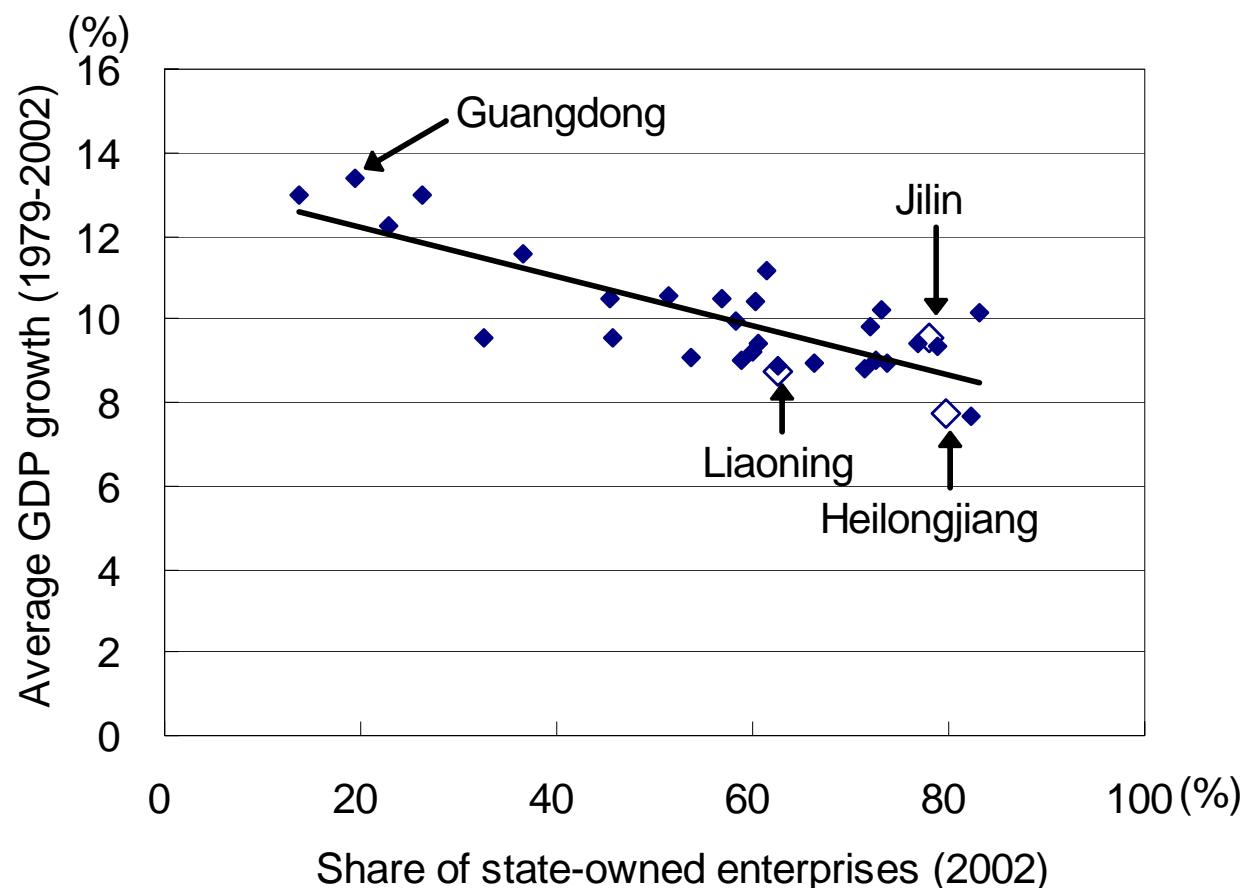
# Whither China's Socialism?

- Transition from plan to market
  - Markets for goods and services
  - Markets for actors of production (labor, land, capital)
- Transition from public to private ownership
  - Growth of non-state-owned enterprises (private and foreign)
  - Privatization
  - Joint stock enterprises as the principal form of public ownership
- Primary stage of socialism or primitive capitalism?
  - Emergence of proletariat and capitalist class
  - Widening income disparities

# Declining Share of SOEs in Industrial Sector



## Negative Correlation between Provincial GDP growth and the share of state-owned enterprises



Note: Results of regression analysis

$$\text{Average GDP growth} = 0.1336 - 0.0584 \times (\text{state-owned enterprises' share of industrial production})$$

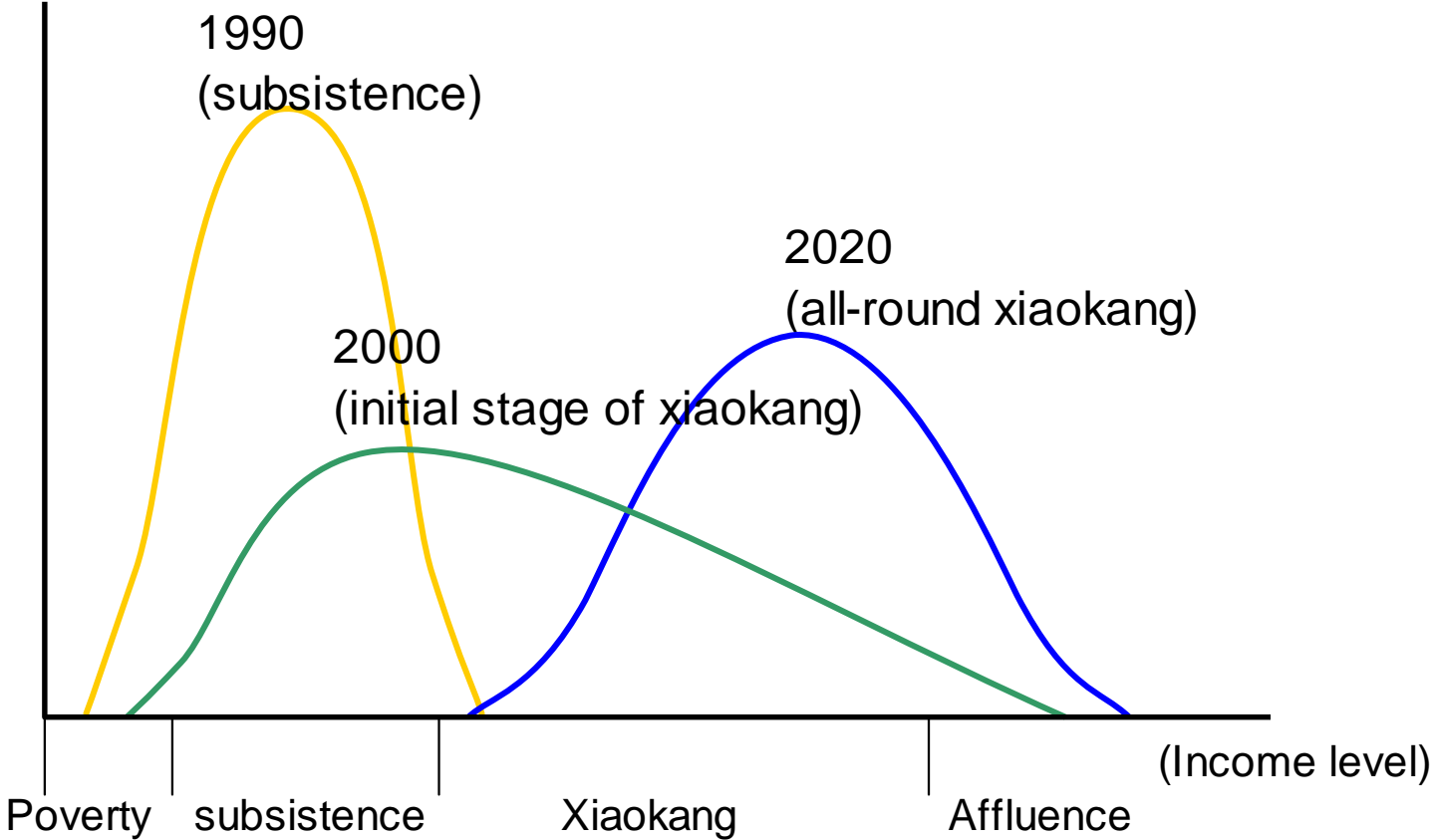
(26.22)\*\*    (-6.99)\*\*

# From Primitive to Matured Capitalism

- Need to shift from rule by leaders to rule by law
- Need to shift from dictatorship to democracy
- Need to strengthen protection of private property rights
- Need to strengthen protection of the weak by establishing safety nets
- Toward an All-round Well-off (Xiaokang) Society

# The Path to an All-round Xiaokang Society

(Percentage of population)





# End of One-Party Dictatorship

- Contradiction between economic base and superstructure
- Three Represents Theory as an attempt at softlanding
- The final stage of peaceful evolution
- Post-Cultural Revolution generation holds the key
- Taiwan and South Korea as examples of smooth transition

# Three scenarios for the China-Taiwan relationship

	Maintaining single-party rule	Maintaining high growth	Unification
(1) Maintaining the status quo			×
(2) Unification through military force		×	
(3) Peaceful unification	×		

# China: Stabilizing or Destabilizing Force in the Global Economy?

- Workshop of the World -- global industrial restructuring
- Market of the World – locomotive of the global economy
- Rising demand for primary commodities (energy and food)
- Pressure on global environment
- Upward pressure on global interest rates?

# G7 needs China, as China needs G7

- Common interests and policy agenda
- Turning G7 from a “rich nations’ club” to “economic powers’ club”
- External pressures help speed up domestic reform

# Is Japan or China the Winner?

- Japan has a share of 60% in E. Asian GDP, and China's share is only 20%
- Shrinking income gap between North and South contributes to regional stability
- Lesson from the Asian crisis – better for Japan to be surrounded by prosperous and stable nations rather than poor and unstable ones