

**How should East Asian countries
accommodate the economic rise of China**

--A Japan's view --

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1. Dramatic growth of Japanese export to China

Japan's export to China doubled only within three years from 2,621 billion Yen (24 billion USD) in 2000 to 5,419 billion Yen (46 billion USD) in 2003 (Jan.-Oct. respectively)

Aggregated export to both China and Hong Kong (which nearly equals to actual export to China) is now close to 3/4 of export to the U.S., which may exceed the former within 2-3 years.

This phenomenon is not limited to Japan, but is also seen in other North East Asian region.

2. Dramatic Change in Japanese big companies' view toward China

Japanese industries were in for a rude awakening with "sudden" emergence of Chinese rivals in 2001. Along with "industry hollowing out" accelerating, "Chinese economic threat" view arose suddenly.

Such a sentiment, however, fell also suddenly through 2002 to 2003 due to the above mentioned "export surge." As far as big companies are concerned, many industries are enjoying "China Boom" (steel, chemical, machine, automobile, electric parts...)

Quite contrastively, however, most of Japanese SMEs have continuously been "losers" in relation to China, due to customer industry's shift to China.

3. Winners and losers in China

China is enjoying rapid economic growth with current growth rate 8.5% annually. In coastal big cities, a bunch of middle class people (if not very wealthy) are emerging, a sign of "take off" of Chinese economy. Some successful non-state enterprises have started foreign direct investment with a view to upgrade their business both in terms of geographic scope as well as of technology level.

However, "losers" in China are:

Inland area: rapid growth without enough income redistribution means the widening gap between coastal area and inland area

Young students and lay off workers: the growth of job applicants much higher than that of the economy

Farmers: although long scared impact by WTO entry is not yet clear, they are not winners definitely. As a means to curve growing income gap between cities and rural areas, Chinese government seems to enhance domestic human mobility, thus tries to guide farmers to move to cities, which move then again strains both social stability and ecological environment there.

4. East Asian economic integration

East Asian region is in a boom of FTA building. Given the region's nature of "world's manufacturing center," getting behind this move puts a country's industry into a disadvantageous position in regional division of labor. In addition, the fact that economic interdependence in the region is deepening makes it more sensible and necessary for a country to follow this move than in ten years ago.

Question is that if these countries can really carry out painful structural reform that necessarily comes up with FTAs, particularly in case of FTA between large economies. The doubt also exists in Japan with anxiety. Voices to call on FTA that involves both Japan and China are heard only among big companies, although they nevertheless remarkably increased from near zero two years ago.

One thing to keep in mind, however, is the fact that such pain comes to reality even without building institutional FTA, but with de-facto economic integration. Quite clear contrast between winners and losers / beneficiaries and sufferers as above in both Japan and China is its evidence.

5. Challenge for Japan and China

In a transitional period, a widening gap between winners and losers / beneficiaries and sufferers is unavoidable. Excessive production factors (labor, capital etc.) sooner or later need to exit from industries that have lost comparative advantage. Although it brings about a big pain to life, it is also a way to enhance a country's economic efficiency and future welfare.

But enabling as much people to come to enjoy the fruit of economic integration is very important not only for the sake of those losers, but for the sake of decreasing the cost of decision making.

For this objective, there are some actions that Japan and China may wish to take. For Japan, many Japanese fail to enjoy the fruit of China's rise not because China doesn't give it, but because they don't dare come to grasp the opportunity. For example, rooted psychological barrier hinders them from awakening that Japan can host more foreign tourists as well as more inbound FDI from neighboring East Asian countries including China than from Western Countries. Only if there is well

developed business route, competitive SMEs can also take orders from China even if they don't move to China.

For China, unlike the past when it was yet sufficiently uniformed as a "national economy," there is a pressing need to make more efforts to manage its growing disequilibrium, widening gaps both in degree of regional development and in personal income level, for example. For this sake, there is no way for China but to head for a "bigger government" policy in order to make more income redistribution between the wealth and the poor.

China also needs to create more jobs. It is shuddering that even 8.5% GDP growth is far from enough to employ current new graduates whose population is much more than ten million per one year old. Given this, China may need to play up labor intensive industries more in its economic development, which move, then again may influence global division of labor more.

6. What to do with regional currency order -another side of a coin of economy?

As China's economic rise becomes clearer, voices calling on RMB appreciation become louder everywhere in the world. Aside from a naive and sentimental accusation that China is thus exporting deflation and unemployment, there is also a suggestion that excessive currency market intervention is also harmful for China's own interests. True, combating current huge demand / supply imbalance in China's FOREX market seems more and more costly, risking upsetting China's domestic monetary policy. In this regard, there is enough reason to call on its policy change.

However, is just widening the floating band of RMB a right direction? Although there are many in Japan to argue so, but taking today's close economic inter linkage into consideration, it must be a nightmare for Japan to see RMB to "free float" like a jet coaster, because Japanese industry would definitely suffer the fallout of such fluctuation. Japan as well as other countries in the region should make joint effort to prevent RMB from falling into the same rut as Japanese yen one or two decades ago for the sake of own interest.

7. Conclusion

Aside from economic issues, the most remarkable outcome of China's rise is a fundamental change taking place in at least some Chinese people's sentiment. It seems that as its economic success recognized both by the rest of the world and by themselves, deep rooted inferiority complex as well as the sense of sufferer has started to be cured. As resumption of their self-confidence, eyesight becomes

broader and the way of thinking also becomes more broad-minded and rational. “China’s new diplomacy” which is recently argued is mere a reflection of such a fundamental change. It might much brighten the prospect of the foreign relations of the East Asia.

But simultaneously there is also radical and emotional nationalism growing particularly in young generation. The more Chinese foreign policy becomes rational, the more this peculiar contrast becomes apparent. With political freedom remaining restricted, ballooning desire for political participation inevitably heads for “loophole,” where even scary authority can not easily clamp down. This must have something to do with circumstances surrounding young generation. As number of students increased three times in the past decade, even university graduates are facing job crunch (if not totally “losers”).

Along with China’s economic rise, Japan and other countries in the region will substantially be influenced by its various changes for good or for bad. What remains unchanged is the fact that we must go through life with a giant neighbor China.