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VIEWPOINT

Capitalist China, Socialist Japan?

In a unanimous vote on November 10, the ministerial meeting of the World Trade Organization in Doha, Qatar, officially approved China's accession to the global trade body. The entry of China, whose gross domestic product is the world's seventh largest, is certain to mean further integration of the global economy and even more intense international competition. This marks the start of a new era for the multilateral free trade system.

Earlier in the same week, on November 6, a summit between China and the members of the Association of Southeast Asian Nations reached agreement to start senior-working-level negotiations aimed at conclusion of a China-ASEAN free trade agreement. In order to overcome the reluctance of ASEAN members who fear China's economic might, the Chinese side proposed a two-stage approach to liberalization under which China will first open up its market for agricultural products and the liberalization of manufactured goods—a source of ASEAN worries—will come second.

To secure admission to the WTO, Beijing made a number of major concessions, such as acceptance of a "Chinese safeguard" clause that will be in effect for 12 years. Apparently the key to successful conclusion of both the admission process and the talks with ASEAN was the willingness of China's top leaders to make difficult political decisions, agreeing to make significant concessions even as they struggle with serious domestic problems in knotty fields like agriculture.

With eyes focused on China from around the world, *Forbes* magazine recently announced its 2001 rankings of China's wealthiest individuals. At the top of the list was Liu Yongxing, head of the Hope Group, with an estimated wealth of $1 billion. So China has entered the age of the billionaire.

According to figures published in the World Bank's *World Development Report 2000/2001*, the distribution of incomes in China is astoundingly similar to that in the United States. The top 20% of the population accounts for 46%–47% of total income in both countries, while the bottom 20% accounts for 5%–6%. Not only that, but the figures for the middle three quintiles are also virtually identical: slightly over 22% of income for the second group of 20% from the top, 15%–16% for the third 20%, and 10%–11% for the fourth. By contrast, Japan's top 20% accounts for a relatively modest 36%, and the bottom 20% has an 11% share; the spread among the second, third, and fourth quintiles is also relatively small, at 22%, 18%, and 14%, respectively.

Over the course of more than half a century since World War II, Japan has built up a society of truly remarkable egalitarianism, much like what the socialist nations were attempting to achieve. But since the 1990s, with

ON OTHER PAGES

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the progress of globalization, the systems on which Japan's success were built have started to be out of kilter with what was required, and people have been calling for their reform. For example, the government operates a postal savings system that has ¥242 trillion in deposits, more than half the total deposits of all the banks in the private sector (¥474 trillion). And in the field of housing loans, the public-sector Housing Loan Corporation has a share of about 40%. These are just two of the most glaring examples of how government-affiliated financial institutions have been crowding out the private sector. Prime Minister Jun'ichiro Koizumi has undertaken a campaign to drastically reform the welter of special-status public corporations, but it is making little headway because of the stubborn resistance of the numerous vested interests involved.

Japan's emphasis on consensus-based decisions and its system of democratic institutions make it impossible for it to practice China's style of top-down politics. But clearly our country needs to find some way to rebuild a vigorous economy while attempting to preserve its egalitarian values—and it needs to do so with all due speed.

China too is being challenged by the demands of globalization, and foreign observers will be watching closely to see how the authorities in Beijing will use the external pressure of WTO membership to achieve their desired "socialist market economy" while preserving the political structure of Communist Party rule. But reading recent news reports of the strategic and dynamic moves that the Chinese are making, I get the strong impression that China may turn itself into a capitalist nation before Japan does.

■ ***Akio Okawara, November 16, 2001***

REPORT

Global Warming and Economic Activity

Four years after the Third Session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (COP 3) adopted the Kyoto Protocol, agreement was finally reached on the knotty issue of operational details at COP 7 in Marrakesh on November 10. The United States did not join in this agreement, and questions remain about the meaning and utility of putting the protocol into effect. Even so, it cannot be denied that the finalization of the Kyoto Protocol rulebook, which requires developed nations to cut back their emissions of greenhouse gases, represents a first step toward the prevention of global warming.

(The Kyoto Protocol considers emissions of various greenhouse gases, including methane and nitrous oxide, but for purposes of this report we will look just at carbon dioxide, which accounts for about 90% of total emissions.)

Current emissions and required reductions

Among the six main developed countries, the rankings of carbon dioxide emissions relative to gross domestic product and population are as follows: United States, Germany, Britain, Japan, Italy, France. The United States' per capita emissions are almost twice those of second-place Germany. The U.S. emission level is also comparatively large relative to GDP. Overall, the U.S. industrial structure may be said to have a high energy consumption level.

The table presents the reduction targets for carbon dioxide emissions under the Kyoto Protocol for these six countries and for the European Union in the 2008–12 commitment period as measured against the emissions in 1990 and 1998. During the 1990s the United States' emission levels rose year by year, reflecting its steady economic growth; as of 1997 it accounted for about one-fourth of the world's total emissions. In 1998 the level was 11.5% greater than in 1990, meaning that a reduction of approximately 17% would be required to meet the Kyoto target of a 7% reduction measured against the 1990 level.

In Japan, whose economy was sluggish during the 1990s, the rate of increase of emission levels was slower than in the United States; the increase from the 1990 level was 5.5% as of 1998 and 9% as of 1999.

For the EU as a whole the Kyoto Protocol sets a reduction target of 8% from the 1990 level, with separate targets for each of the 15 member countries. The EU's overall 1998

Carbon Dioxide Emissions and Reduction Targets of Major Developed Countries

	Emissions (million tons)		Reduction target (%)	
	1990	1998	from 1990	from 1998
United States	4,914	5,478	7	17
Japan	1,125	1,187	6	11
EU	3,324	3,335	8	8
France	388	413	0	6
Italy	433	459	7	12
Germany	1,015	886	21	10
Britain	584	546	13	6

Source: United Nations Framework Convention on Climate Change data.

emission level was virtually unchanged from 1990, but differences are seen in the emissions records of France, Italy, Germany, and Britain, which together account for about 70% of the EU total.

In France and Italy, whose emissions are relatively low, the levels rose in tandem with economic growth during the 1990s, especially from 1994 on, and both countries' emissions were 6% higher in 1998 than in 1990. In Germany and Britain, by contrast, though economic growth continued at a moderate pace during the decade, the level of carbon dioxide emissions actually fell. As of 1998 Germany's level was down 13% from 1990, and Britain's level was down 7%. Germany's record benefited from the closing of older factories in the former East Germany; this and other considerations have led to some complaints that the targets give the EU an unfair advantage.

The use of 1990 as the base year for setting reduction targets means that the heaviest burden of cutting current emissions falls on the United States, which powered the global economy with its strong growth during the 1990s. The prime reason the United States has rejected the Kyoto accord is the negative impact on its own economy; however, the Americans are also dissatisfied with the fact that the protocol does not require any reductions by the developing countries. According to the estimates of the Intergovernmental Panel on Climate Change, emissions by the developing countries accounted for about 30% of the global total in 1990 but will account for about 50% as of 2020, and if the economies in transition are included, the estimated 2020 share comes to 60%; the developed countries will account for less than half.

In particular China, whose economy has been advancing rapidly in recent years, reached an emission level of 3.16 billion tons as of 1997, an increase of over 30% from 1990; at this point it was already emitting about 2.5 times as much carbon dioxide as Japan. Given the prospects for China's continuing growth, along with the fact that India is already the world's fifth largest source of emissions, the noninvolvement of the developing world in the emission-cutting regime goes against the spirit of the Kyoto Protocol, which seeks to protect the environment on a global scale. At COP 7 in Marrakesh this year it was agreed for the first time to start negotiations concerning the addition of the developing countries to the regime, but there is still no clear idea when or how this will actually be achieved.

Striving for a more effective approach

Now that the operational details of the Kyoto Protocol have been formalized, efforts are underway to secure ratification of the protocol so that it can go into effect by the time of the World Summit on Sustainable Development to be held next September in Johannesburg.

Within Japan, meanwhile, moves will be required to establish the necessary legislative framework for compliance to reduce emissions, along with measures to deal with global warming on a medium- to long-term basis, including efforts to reduce emissions in the commercial/residential and transport sectors, which lag behind the industrial sector in this respect, and the provision of support for technological development. Japan has been allowed to subtract 3.9% from its reduction target based on the role of forests as carbon dioxide sinks, but even so it will be hard to meet the target, since this country is already conserving energy fairly diligently and has a relatively low level of per capita emissions. In addition, some people are expressing reservations about ratifying the protocol in view of its rejection by the United States, which calls its overall effectiveness into doubt, and the possible impact on the competitiveness of Japanese industry.

The prevention of global warming is a global-scale issue to be dealt with on a long-term basis over the entire twenty-first century. It is important to address it with a globally uniform set of rules that apply also to the United States and the developing countries. Another important consideration is that the measures against climate change be compatible with sustained economic development. And it will probably become necessary to build arrangements that make use of the market mechanism, as seen in the moves by European and American businesses to build up the nascent market for emissions trading.

■ ***Tadashi Takimoto***
November 13, 2001

INTERNATIONAL AFFAIRS

This section takes a look at major topics on the international scene, offering an outline of developments together with highlights of media commentary and reports from research institutes.

Argentina on the brink of default

The so-called Paris Club had its start in 1956, when creditor nations gathered in Paris to discuss rescheduling Argentina's delinquent external debts so as to avoid default. Once again this year, as the global economy stagnates, fears of a default by Argentina have come to the fore. The South American nation is now carrying a load of more than $130 billion in external obligations.

In July this year President Fernando de la Rua and Economy Minister Domingo Cavallo adopted a set of austerity measures aimed at cutting the budget deficit to zero, based on which they received an agreement for an additional $8 billion lending package from the International Monetary Fund in August; $5 billion of this was provided in September, enabling the country to weather the crisis for the moment. But to receive the remaining $3 billion the government needs to renegotiate the terms of its foreign debt, and negotiations toward this end have not been going well.

Also, in order to achieve its planned balancing of the budget, the government needs to implement a comprehensive set of bold austerity measures, including cuts in revenue sharing for the provinces, in government employee salaries, and in interest payments on public borrowing from pension funds, but many of the provincial governors are holding out firmly against the revenue-sharing cuts, and the outlook for implementation of the various measures is clouded.

Meanwhile, the U.S. credit-rating agency Standard and Poors on October 30 lowered its rating of Argentina's long-term debt from CCC+ to CC, making it even more difficult for the hard-pressed country to raise funds.

In the view of a leading British think tank, even the desperate measures that the government is taking may not be enough to avert default. High interest rates and low liquidity are likely to limit the effectiveness of the tax benefits the government has offered in order to stimulate the economy. The analysts at the think tank have judged that the authorities' economic measures are merely an attempt to gain time and that the effort to restructure existing obligations will probably amount to no more than an attempt to carry out a "controlled" default.

In its November 3 issue, the *Economist*, noting that Argentina has already received substantial amounts of IMF lending, dryly observed, "There is no reason for more aid to reward investors who have long been aware of a default risk."

But as the IMF pointed out in its October 2001 *World Economic Outlook*, Argentina's economic difficulties have adversely affected its neighbors, and if it defaults on its foreign obligations, global investors are likely to become even more averse to risk; this could mean a sharp reduction in the availability of funds for the heavily indebted emerging-market countries, thereby possibly setting off another emerging-market crisis.

Sparks from the smoldering situation in Argentina could set off a wider conflagration in global financial markets.

WTO meeting in Doha: Agreement on new round and admission for China

On November 14, ministers attending the World Trade Organization meeting in Doha, Qatar, reached an agreement on the launching of a new round of global trade negotiations.

The two main items on the agenda of the meeting this time were the new round and the admission of China and Taiwan. And following the September 11 terrorist attacks in the United States, there was an additional important goal, namely, to hold the meeting as scheduled without major incident.

As the *Economist* noted in a leader (editorial) in its November 3 issue, before the meeting convened, "Now success at Doha, in Qatar, has become part of the anti-terrorist arsenal." The British weekly also observed, "With the world economy tipping into recession, the promise of freer trade should give a much-needed boost to confidence." And it continued, "The meeting's very location [in the capital of an Islamic nation] sends helpful signals about the Muslim world's support for globalisation."

On the subject of China's accession to the global trade body, a story in the November 13 *Washington Post* reported, "To secure the approval of trade ministers [for its admission] . . ., China was obliged to promise that it would slash tariffs, curb official subsidies and scrap many other barriers that have long shielded workers here from the rough-and-tumble competition of global capitalism." The story went on to point out, "These changes are expected to bring long-term economic benefits. . . . But they will also bring short-term hardship for hundreds of millions of ordinary Chinese citizens, and pose daunting challenges to the party's continued legitimacy."

The source of China's competitiveness as an exporter is its plentiful supply of low-cost labor. Particularly for the countries of Southeast Asia that have built a position as workshops for the world with their labor-intensive manufacturing industries, China is a powerful new competitor. These countries may find it impossible to compete successfully with Chinese industry, and major trade frictions may emerge.

At the same time, however, the addition of the immense Chinese market, home to 1.3 billion people, or about one-fifth of the world's population, to the free-market economic system is a major step forward. President Jiang Zemin has promised that China's development will not threaten other countries but will promote the development and stability of its Asian neighbors and the world as a whole. While one may choose not to take his words at face value, China's WTO accession is certain to be a significant positive factor for the global economy.

The *Economist*, in a Global Agenda article on its website dated November 14, offered this cautionary note about the new round: "If the negotiations are to succeed, the principal challenge is for the rich countries: America must show it can deliver the concessions it has offered, and Europe must demonstrate it is committed to free trade even when this annoys its inefficient farmers."

And the *New York Times* opined on November 15, "Speed matters, since regional trading blocs in the Americas, Africa and Asia could expand rapidly over the next several years. By completing a pact soon, the W.T.O. can confirm its role as the world's main forum for trade liberalization."

The new round promises to be a testing ground for the true value of the WTO.

■ ***Takaya Mitamura***
November 16, 2001

INSIDE WASHINGTON

After September 11

The terrorist attacks of September 11 and the subsequent spread of anthrax through the mail have affected ordinary Americans' lives in diverse ways. The most noticeable impact has been the precipitous fall in air travel, formerly regarded as routine. Jarred by media reports of the sloppy security procedures at U.S. airports and the crash (apparently accidental) of an airliner in the New York City borough of Queens on November 12, many Americans are planning to avoid long-distance travel over the Thanksgiving and Christmas holidays, opting to stay close to home or, at most, go no farther than they can comfortably drive.

There is also a new wariness of letters and parcels from unknown sources. And since September 11 not only trash containers but even newspaper vending machines have been removed from all subway stations in the Washington, D.C., area.

Sales of gas masks have soared, sparked by fears of further attacks using biological or chemical weapons. One manufacturer has reported that sales are up 375% over the same time last year. Meanwhile, some 3 million prescriptions for Cipro, an antibiotic effective in treating anthrax, have been issued nationwide.

Many Americans are expressing a heightened sense of patriotism by decorating their homes and cars with the Stars and Stripes. The major retail chain Walmart sold 450,000 American flags in the first three days after September 11 alone.

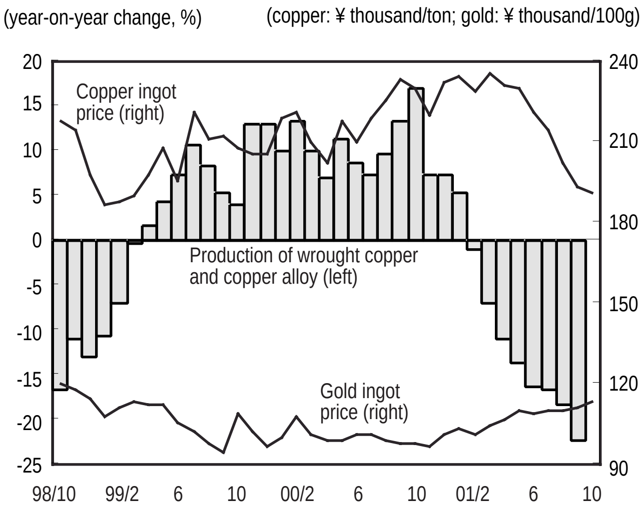
A more unusual phenomenon has been the rise in orders to modify limousines by bulletproofing them and installing computer equipment and Internet linkups—making them into mobile armored offices, as it were. Once upon a time most demand for such vehicles emanated from regions like Latin America and the Middle East, but since September 11 there has been a spate of inquiries and orders from East Coast businesses and limousine-rental companies.

The period between Thanksgiving and Christmas is the time of year when Americans traditionally spend the most. This year, although many economists are forecasting a plunge into recession, some opinion polls indicate that most consumers are planning to spend about the same as usual in the leadup to Christmas. Consumer sentiment appears to be more buoyant than generally thought, but prediction is a dangerous business in these volatile times.

■ ***Kunio Tsurumi, Washington***
November 15, 2001

JAPANESE INDUSTRY

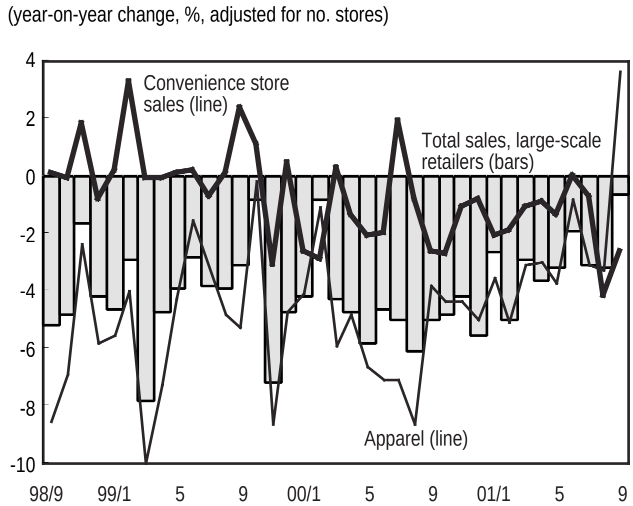
NONFERROUS METALS



Sources: Economy, Trade, and Industry Statistics Association, etc.

Production of wrought copper and copper alloy in September was down 22.3% from a year before, the eighth straight monthly decline. The drop was especially big in IT-related areas: Copper strips for semiconductors fell by 30.4% and bronze sheet for electronic parts by 35.6%. Three-month copper futures on the LME hit a 15-year low.

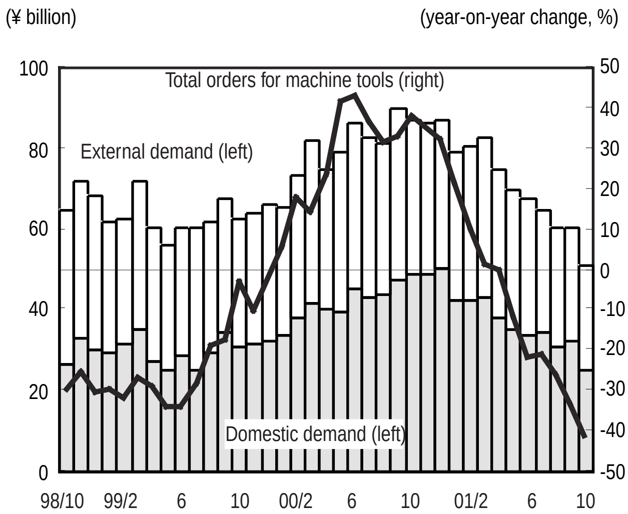
RETAIL



Source: Research Institute of Economy, Trade, and Industry.

September department store sales rose for the first time in three months. Autumn clothing moved well, and remodeling of stores along with bargain sales helped improve results. But supermarket sales fell for the 34th month in a row. Food and home-related products were weak; mad-cow-disease fears pulled down beef sales by 40%–50%.

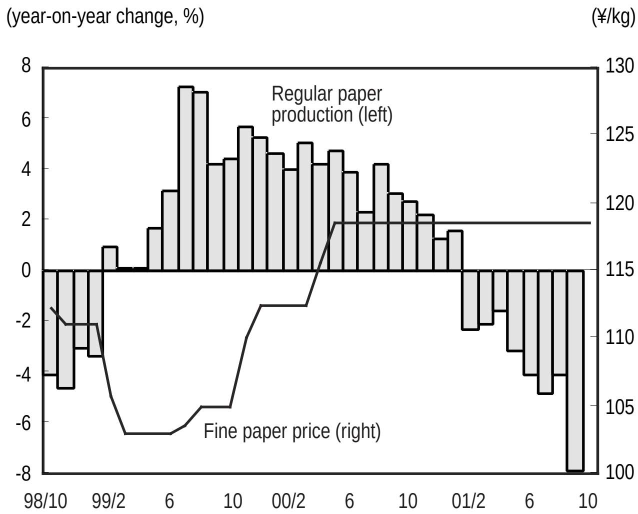
MACHINE TOOLS



Source: Japan Machine Tool Builders Association.

Orders in October fell for the sixth straight month, dropping by 41.5% to ¥50.77 billion; for the first time since May 1999 the figure fell below ¥60 billion. Domestic demand plunged by 48.7%, reflecting the sharp drop in business investment since the September terrorist attacks.

PAPER & PULP



Sources: Japan Paper Association, etc.

Regular paper production fell for the eighth straight month. Exports of used paper were six times greater than a year before. Demand for Japan's high-quality used paper is strong in China, and its price in Asian markets is firm.

■ ***Kanji Ishitsuka and Yuko Furukawa, November 13, 2001***

WORLD ECONOMY

Major stock markets around the world have to a large extent recovered from the losses they suffered following the September terrorist attacks. However, fears remain that demand will drop off further in real economies, and in many countries the employment situation has deteriorated markedly. At the end of October the World Bank issued downward revisions of its forecasts for economic growth (Table 1).

Table 1. Economic Growth Outlook

(%)

	2000	2001	2001	2002	2002
World	3.8	2.2	1.3	3.3	1.6
United States	4.1	1.2	1.1	3.3	1.0
Japan	1.5	0.6	-0.8	1.8	0.1
Euro zone	3.5	2.5	1.5	3.1	1.3
World trade	13.3	5.5	1.0	7.3	4.0

Source: World Bank, *Global Economic Prospects 2002*.
Note: Shaded columns show projections as of April 2001.

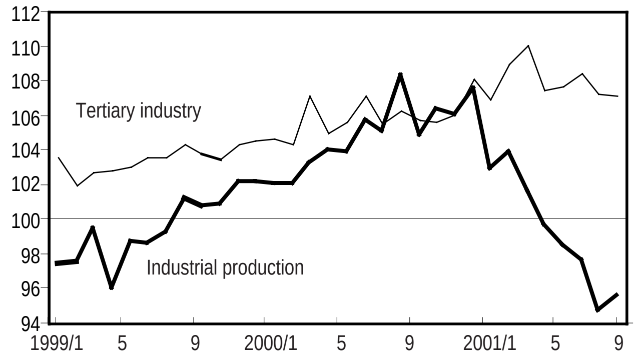
Japan

Economic indicators in **Japan** reveal a worsening situation. In November the government lowered its outlook for growth in fiscal 2001 (ending March 2002) from 1.7% to -0.9%.

Industrial production has been following a downward trend since the latter part of 2000, and the figure for September was down 2.9% from the previous month, reflecting drops in such industries as electrical machinery, general machinery, and metals. The weakness in manufacturing is also affecting the nonmanufacturing sector, and the tertiary industry activity index has declined for two straight months (see the figure). The figures for wholesale and retail trade are down, and growth in services has decelerated. Machinery orders in the July–September quarter were off 5.7% from the previous quarter, contributing to the widespread view that the recovery will be delayed.

Economic Activity Indexes, Japan

(1995 = 100)



Source: Ministry of Economy, Trade, and Industry.

The employment picture also continues to darken. The number of people employed declined for the sixth straight month in September, and the unemployment rate for the month rose to a record high of 5.3%. The September survey of consumer sentiment revealed a major drop in consumer confidence, reflecting the impact of concerns about jobs, and it is feared that consumer spending will decline in the period to come.

Exports in September were down 11.1% from a year before; it was the sixth consecutive month of year-on-year declines. Exports to other Asian economies have fallen especially sharply. Imports were also off for the second straight month.

Americas

The economy of the **United States** is cooling off rapidly, and the growth rate for July–September came in at a negative 0.4% in annualized terms. Growth slowed further in both consumer spending and residential investment, and the positive contributions from these areas were more than offset by the sharp downturn in plant and equipment investment by businesses. Most observers expect the economy to contract by an even larger margin in the October–December quarter.

The industrial production index fell for the twelfth straight month in September, marking the longest string of declines since World War II, and manufacturing orders were down sharply by 5.8% from the previous month. Meanwhile the unemployment rate has been heading up, reaching 5.4% in October. The numbers of people employed have fallen sharply in services as well as in manufacturing, showing the spread of job cuts in response to the economic downturn. The combination of the September 11 attacks, the anthrax incidents, and the deteriorating job situation has taken a heavy toll on economic sentiment, and consumer spending, which had up to recently been holding firm, registered a big drop of 1.8% from the previous month in September.

In November the Federal Reserve Board cut interest rates for the tenth time this year, pushing the federal funds rate to 2.0%, the lowest level in 40 years.

The recession in **Argentina** has continued to become more serious. Consumer spending–related indexes have been extremely weak, and imports plunged 22% from a year before in August. Given the decline in tax revenues resulting from the economic downturn, a consensus has developed among financial market participants that restructuring of the country's debt will eventually be inevitable.

Europe

Economic sentiment has also been worsening in Europe, which had been doing relatively well until recently, and observers are increasingly guarded in their view of the prospects for the period ahead. Fears of inflation in the euro zone have receded dramatically because of the global economic downturn, the halt in the euro's fall against the dollar, and the softening of crude oil prices. Responding to the weakening of sentiment within the European Union, the European Central Bank cut its benchmark interest rate by half a percentage point in November.

Professional observers are becoming less sanguine in their outlook for **Germany**'s economy. Because of the downturn in plant and equipment investment, the six leading economic research institutes have forecast that this year's growth rate will be only 0.7%. In October the unemployment rate rose to 9.5%. Joblessness has also been rising in **France** since June, and in September the rate reached 9.1%, leading to widespread concern that economic sentiment in the household sector, which has been powering growth, may weaken.

In **Britain** the real quarterly growth rate of gross domestic product in July–September was 0.6%. The country is widely seen as being in better economic shape than the United States and the euro zone.

Asia

Exports have been declining sharply in Asia, particularly among the Asian NIEs, or newly industrialized economies, and this has been exerting a negative impact on production levels. In November the Asian Development Bank issued a new set of lower growth forecasts for the region. The margin of downward revision was especially large for the NIEs, which depend heavily on exports (Table 2).

Table 2. Economic Growth Outlook for Asia

(%)

	2000	2001	2001	2002
Asia and the Pacific	7.0	5.3	3.4	4.5
Asian NIEs	8.4	4.3	0.1	2.7
South Korea	8.8	3.9	2.0	3.6
Taiwan	5.9	5.1	-2.0	5.1
Hong Kong	10.5	4.0	-0.4	2.0
Singapore	9.9	5.0	-3.0	5.0
China	8.0	7.3	7.3	7.0
Southeast Asia	5.2	4.0	2.4	3.3
India	5.2	6.2	5.6	6.3

Source: Asian Development Bank, *Asian Development Outlook 2001 Update.*
Notes: The figures for "Asia and the Pacific" exclude Japan. The shaded column shows projections as of April 2001.

Industrial production in **Taiwan** was down 14.1% from the previous year in September, the sharpest decline on record. In **Hong Kong** consumer spending has turned sluggish, reflecting such negatives as higher unemployment and lower stock prices. Retail sales in September were down 4.4% from a year before. The preliminary figure for July–September GDP in **Singapore** showed a year-on-year decline of 5.6%. Manufacturing production plunged 22.3%, and in the electronics industry the decline was 35.5%.

The economy of **Thailand** has been losing momentum at a relatively gradual pace up to now, but the year-on-year growth rate for manufacturing production turned negative (-1.7%) in September. Meanwhile the decline in **Malaysia**'s industrial production has become even more pronounced; the figure for September was down 9.7% from a year before.

Real GDP growth in **China** for July–September came to 7.0% year on year, down from the 7.9% growth rate recorded in the first half of the year. Exports, which surged by 27.9% last year, have been rapidly slowing, and their rate of expansion for the July–September quarter was only 3.9%.

■ ***Fumio Oi, November 15, 2001***

Economic Trends is the English summary of *Keizai Dôkô*, a monthly Japanese report on economic trends in Japan and other countries produced by the Information Analysis and Research Department, Sumitomo Corporation. *Keizai Dôkô* and *Economic Trends* are also available on the Internet (http://www.sumitomocorp.co.jp/econo). If you have any questions or suggestions concerning *Economic Trends*, please do not hesitate to contact us (see cover page for contact information)