Chapter 1 Growing into "the market of the world"— depends upon the realization of a higher income level and smaller income gaps

[Key Points]

1. China's ongoing market-oriented reform and open-door policy are prompting its markets to grow. Non-state-owned enterprises have become major market players and the driving force of the economic growth. Under the market economic system that is fast taking shape, most prices have come to be determined by the market, and the government's economic policy has shifted from direct control to indirect guidance. The intensifying competition and the accelerating reform under the open-door policy are prompting the economy to be more efficient and promoting the overall growth of the economy.
2. For further market expansion in the future, China has to strengthen the protection of property rights, to establish an environment of fair competition, and to build a unified national market. Market expansion also requires sustainable economic growth through higher production efficiency, income gap correction, and industrial upgrading.
3. At this moment, China is better characterized as "the factory of the world" rather than "the market of the world." However, as China comes closer to the realization of an "all-round well-off society" that aims at higher living standards and equal income distribution, China will become more attractive as a market for final products as well.

Introduction

Ever since its shift to the reform and open-door policy in the late 1970s under Deng Xiaoping's initiative, the Chinese economy has continued to grow at an average rate of 9% a year. In 2004, China recorded total exports and imports amounting to $1.15 trillion, to replace Japan as the world's third-biggest trading nation after the U.S. and Germany. Leveraged by direct foreign investment, China has ridden the wave of industrialization and has come to be known as "the factory of the world." China has the potential of developing into "the market of the world" as well.

As of today, however, on a dollar basis, China's gross domestic product (GDP) remains at one-third that of Japan despite its tenfold population. Furthermore, for Japanese firms, China is still more a production base than a market for final products. The recent increase in Japan's exports to China is supported mainly by producer goods such as machinery and parts, and a large part of the products processed in China are exported to Japan and beyond to third-country markets. Local production for local sales by Japanese-owned firms in China (including Hong Kong) during 2003 amounted to only $18.4 billion, only about 10 percent of their same activities performed in North

America (source: *Quarterly Survey of Overseas Subsidiaries*, Ministry of Economy, Trade and Industry).

Essentially, production growth should lead to a corresponding increase in income and spending, and consequently to greater markets. In China, however, increases in income centers around urban areas and does not boost consumption among people living in rural areas, who account for 60 percent of the population. Thus, the ratio of private consumption to GDP is quite low as compared with other countries. As a result, demand has to be supported by investment (particularly public investment) and exports. Investment increase of this kind, however, has led to lower investment efficiency, while export growth has caused trade frictions and worsened China's terms of trade (ratio of the export price to the import price).

Further market growth in the future will depend upon the continuation of high economic growth, which will be made possible by overcoming structural problems and increasing real income. Specifically, China needs to shift to a development strategy that lays emphasis on higher productivity and industrial upgrading, and seek to boost domestic demand through the correction of intra-regional income disparities. China also needs to establish market discipline, which ensures that contracts and laws are adhered to by all market participants.

1. Reform and market opening that have brought about market expansion

The transition to a market economy and the market opening are the driving forces of market expansion in China. In his *Wealth of Nations*, Adam Smith, the father of economics, sought the key to productivity improvement and economic growth in the division of labor, and emphasized that the degree of the division labor would be limited by the size of the market, which in turn depends not only on the size of the population but also the levels of income and production. China has pushed forward market opening and now finds itself precisely in a virtuous cycle of progressing division of labor and market expansion.

1.1 Transition to a market economy

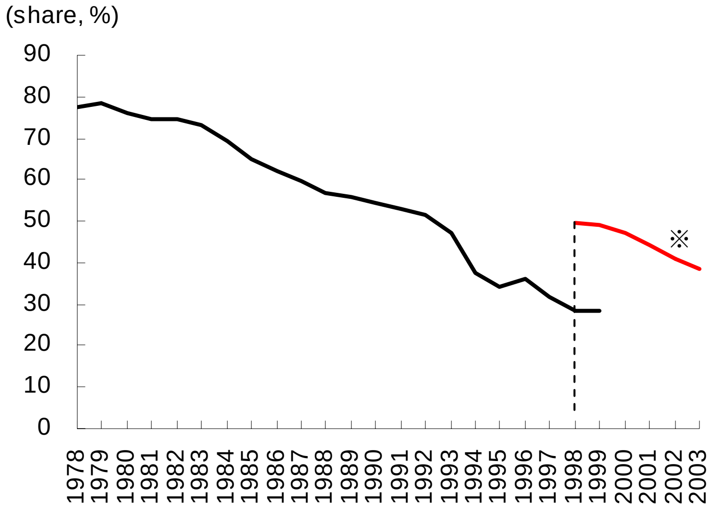
In the era when China was under the planned economy system, almost all productive activities were carried out as planned by the government and no private business was allowed to exist. No market existed except for exchanging consumer goods under government control. Since 1978, the market mechanism has started to work, leading to higher productivity and lower transaction costs. The domain of the market economy has expanded to cover not only goods and services but also factors of production such as labor, capital and land. Major economic players have shifted from state-owned enterprises to non-state-owned enterprises including private firms.

In keeping with the progressing market economy, the role played by resource allocation through the market mechanism has become increasingly important. At present, the ratio of government-priced products and those subject to governmental guideline prices to all marketable products are, at retail level, about 4 percent and 1 percent, respectively, while all other products are priced through the market mechanism. Directive plans for agricultural products have all been rescinded. Furthermore, markets for various factors of production have rapidly grown. Markets for capital, real estate, and labor have expanded. Monopolies prevailing in certain sectors and artificial barriers segmenting various regions have gradually been broken down, and a unified national market is taking shape.

A macro-control system for the market economy is being built, and progress has been made in the areas of planning, investment, fiscal, monetary and taxation matters, external trade, and foreign exchange. Previously practiced directive plans have been revoked, and governmental activities are now being focused on the execution of macroeconomic or strategic policies concerning the development of the national economy and society. The 11th five-year "plan" (2006-2010) being drawn up is now described as "guideline" rather than as the traditional "plan." Measures to stabilize the macroeconomy have shifted from direct administrative measures to indirect market-based instruments.

At the same time, non-state-owned enterprises including private firms are replacing state-owned enterprises as major players in the market. Whereas private property was deemed to be the root of all evil in the era of the planned economy, in the late 1970s under the initiative of Deng Xiaoping people were encouraged to pursue wealth by running privately-owned companies. By providing incentives for both entrepreneurs and workers to work hard and to innovate, this has served as the driving force of the economic growth. As the market economy advances, many township and village enterprises have undergone ownership reform and changed to private enterprises from traditional collective ownership in parallel with the ongoing privatization of state-owned enterprises. As a result, state-owned enterprises' share of industrial production has dropped from about 80 percent in 1978 to below 30 percent now (see Fig. 1).

Figure 1. Declining share of state-owned enterprises
in industrial production



※ The 1998 statistics are taken on state-run enterprises and nonstate enterprises above a certain scale (annual sales of 5 million yuan or more), and not on all enterprises as previously done. This change makes the share of state-run enterprises appear higher, but if calculated by the traditional method, their share should now be below 30 percent.
Source: Compiled from *China Statistical Yearbook*.

Under the planned economy system, the government not only owned most of the enterprises but also directly participated in their management. Thus, these enterprises were "state-run" in reality and in name. However, the decentralization and the "separation of administrative and corporate functions" carried out in the 1980s essentially limited the government's role to that of a shareholder, and substantially increased the autonomy of enterprises. On the back of such change, "state-run enterprises" were renamed "state-owned enterprises" in the early 1990s. Since the mid-1990s, the government has pushed forward the privatization of state-owned enterprises first under the principle of "grasp the big, unleash the small," and then further through "strategic reorganization of the state-owned economy." While the former policy limits privatization to small to medium size state-owned enterprises, the latter goes one step further to have state-owned enterprises, including large ones, withdraw from fields where they compete with private enterprises.

In fact, to accelerate privatization, in "the decision on some issues regarding the improvement of the socialist market economic system," adopted at the 3rd plenary session of the 16th Central Committee of the Chinese Communist Party held in October 2003, the "shareholding system" came to be recognized as the principal form of public ownership in place of traditional state-owned enterprises. As used herein, the "shareholding system" is "a mixed ownership system" in which ownership is shared by state capital, collective capital and non-publicly owned capital alike. By the policy adopted under the said decision, the state is not necessarily the majority shareholder in a shareholding company. With the traditional ideology fading away, a growing number of foreign firms and private enterprises are participating in the privatization of state-owned enterprises through mergers and acquisitions as well as by other means.

1.2 Advancing market opening

In 1978, China started to reform its economic system and, at the same time, changed from its policy of "self-reliance" to that of market opening. After coming through a step-by-step process of expanding areas opened to foreign investors, China entered the stage of complete opening up following its entry into the World Trade Organization (WTO) in 2001. Through market opening, China has gained access not only to world markets but also to technology and management know-how that accompany the entry of foreign companies into China.

Since 1980, China has established five special economic zones in Shenzhen, Zhuhai and Shantou in Guangdong Province, Xiamen in Fujian Province, and Hainan Province. In 1984, China further opened 14 coastal cities to the outside world, including Dalian, Tianjin, Shanghai, and Guangzhou. Starting from 1985, China added the Yangtze River Delta, Pearl River (Zhujiang) Delta, South Fujian Triangle, Shandong Peninsula, Liaodong Peninsula, Hebei and Guangxi to the list of economic open areas, thus forming an open coastal economic belt. In 1990, the Chinese government decided to develop and open Shanghai's Pudong Area, and further open a number of cities along the Yangtze River, thus forming the Yangtze River Open Belt with Pudong as the leader. Since 1992, the Chinese government has opened a number of border cities and the capital cities of all the inland provinces and autonomous regions; set up 15 bonded zones, 49 state-level economic and technological development zones, and 53 new- and high-tech industrial development zones in some medium- and large-sized cities. Consequently, China has formed an all-round, multi-level, wide-ranging opening-up setup integrating the coastal regions, border regions, riverine regions and inland regions. As these areas adopt different preferential policies, they have served as windows and played the radiating role in developing an export-oriented economy, generating foreign exchange earnings by exporting products, and importing advanced technologies.

Along with the expansion of economic open areas, China has also proceeded with pursuing a market economic system, globalization and the rule of law. Particularly, since becoming a WTO member in 2001, these policies have become national objectives to be pursued as an international commitment. Following the elimination or substantial reduction of import barriers such as import duties, China is becoming more and more integrated into the world economy based on its comparative advantage. In addition, further market opening will accelerate competition and reform, urging economic efficiency to improve further, and ultimately promoting the growth of the Chinese economy. In fact, subsequent to entry into the WTO the Chinese economy has remained in good shape, while the reform and opening process has accelerated.

Initially, it was feared that the entry into the WTO might have adverse effect on the Chinese economy, at least in the short term. In retrospect, however, most people feel that the entry has proved very successful. In addition to robust export growth, the inflow of direct foreign investment continues to be in a boom exceeding $60 billion in 2004. Investment has been increasing in capital- and technology-intensive industries, contributing to industrial upgrading.

2. Problems to overcome for further market expansion

As seen above, thanks to the reform and opening process, China has entered into a period of high growth. However, the nation's per capita income is still at a very low level of around 1,000 dollars. To sustain economic growth, China must make efforts to establish market discipline, improve productivity, reduce income gaps, and upgrade its industrial structure.

2.1 Establishing market discipline

For the market mechanism to function, protection of property rights and fair competition are required as preconditions. In China, however, neither of the two is adequately satisfied (Mao Yu Shi, "What constitutes the base of national strength is a market system maintained by morality," http://www.rieti.go.jp/users/china-tr/jp/031117gakusya.htm, in Japanese).

China faces many problems relating to the protection of property rights. Time and time again, incidents occur where state assets are put into private pockets through illegal means and corruption. Some state-owned enterprises provide more than the necessary bonuses, while some others window-dress their financial statements to appear to be profitable despite posting considerable losses. Furthermore, many state-owned enterprises that borrow from state-owned banks have defaulted, impairing depositors' (or taxpayers') interests.

At the same time, private property rights are not adequately protected. Burglary, intimidation and fraud have become common place, while governments at all levels forcibly collect charges or impose penalties using all kinds of excuses, thereby infringing upon the common people's property rights. Most notable are the burdens put on farmers. Many entrepreneurs hold back on investing for fear of their purchased land, housing, companies or factories being confiscated. Such fear prompts them to pull out of a business after making some money or massively remit their assets overseas. Some companies are unwilling to pay their creditors, and some infringe on the intellectual property rights of others. Such incidents are repeated endlessly, disrupting marketing discipline.

To make matters worse, a fair competition environment has yet to be established. Rationing, which was used to regulate trade in goods, has been largely reduced but not completely abolished. Sales of agricultural products are to a large extent controlled by the government. A good part of foreign trade is also subject to nonmarket measures such as a quota or licensing system. Markets for electricity, oil and natural gas, and still further land are not accessible to all those sufficiently capitalized because their access is limited to those who have personal connections. An entrepreneur with abundant capital but not political power will have to pay a much higher cost for such transactions, and, thus, political power has become an important source of competitiveness. In an environment where political power is deeply involved, the market principle of free trade is destroyed. People seek to make money through bribery and other illegal means, rather than by pursuing cost cutting and higher efficiency in a fair competitive market. Consequently, people pander to those in power and may get involved in a power struggle in a desperate attempt to enter the bureaucracy, dedicating their strength and energy to unproductive "rent-seeking activities." This kind of social environment makes it difficult for the Chinese society to transform itself into an efficient, affluent society.

At the 10th National People's Congress (equivalent of a parliament) held in March 2004, Prime Minister Wen Jiabao delivered a report on the government's activities, which included the following measures intended to improve market discipline:

> "We need to quickly establish a system to ensure credibility in society. We need to make intensive efforts to put in place a system for collecting information on the credibility of enterprises and individuals, a system for overseeing the credit market, and a mechanism for penalizing those who lose their credibility. We should intensify our efforts to rectify and standardize the market order, giving priority to cleaning up markets that have a direct bearing on people's health and lives such as those for food and medicine. Producing and marketing counterfeit and shoddy goods, pyramid schemes and commercial fraud must be severely punished. Intellectual property rights must be protected more effectively, and piracy and patent infringement must be punished in accordance with the law. We must severely crack down on tax evasion, tax fraud, money laundering, smuggling and other illegal and criminal activities."

2.2 More Emphasis on the quality of growth

Any further market expansion is fundamentally predicated upon the continuation of high growth. To achieve sustainable growth, China must avoid constraints on resources, environments, markets, capital and human resources. Such avoidance is meant not only for China's development but also for preventing frictions with the international community (Zhang You Wen, *Liberation Daily* dated June 21, 2004).

In the first place, factors that are likely to restrict China's future growth are shortages of resources and environmental destruction. The idea or pattern of maintaining economic growth at the sacrifice of the ecosystem has run into a blind alley, and people are increasingly aware that the deteriorating ecosystem and resources depletion pose risks to China's sustainable economic growth. China is not rich in natural resources, and its own resources fail to satisfy its current demand, let alone future demand. Amid increasing oil imports, people are now more concerned about the security issue relating to energy. To overcome the constraints on resources, China needs to enhance production efficiency capitalizing on the fruits of scientific and technological revolutions, while hastening the shift to a resource-saving economic structure. Energy-saving efforts, in particular, will be conducive to resources saving and environmental improvement.

The second factor is how much China will be able to enhance investment efficiency. Over the past twenty years, China has been able to expand investment, supported by high savings rates and a massive inflow of foreign capital. With the expansion of its economy, however, China's dependence on foreign capital has been decreasing in relative terms. On the other hand, China will face a rapidly aging society after 2020, and, consequently, a declining rate of savings. To sustain economic growth on limited capital, China needs to reform the financial sector, led by banks and securities markets, to promote a more efficient allocation of available funds.

The last factor is how China will be able to achieve an improvement of human resources by means of education. Currently, China is increasing the export of labor-intensive products by taking advantage of its cheap labor cost; however, this has caused China's terms of trade (the relative price between exports and imports) to continue worsening. As a result, the level of people's real income (living standards) has been lagging behind the rate of economic growth. To get out of this trap of "immiserizing growth," China is required to upgrade its industrial structure, which will be predicated upon higher labor quality.

Princeton University Professor Paul Krugman indicated in his paper titled "The Myth of Asia's Miracle" (*Foreign Affairs* 1994) published some ten years ago that the high growth achieved in East Asian countries, which came to be called the "East Asian Miracle," was made possible by increased input rather than improved productivity, and, therefore, would not be sustainable. Years later, the so-called Asian economic crisis struck Thailand, Indonesia and South Korea, only to prove that Krugman's prediction was true. In order not to repeat the Asian countries' bitter experience, China must shift the engine of growth from input increase to productivity improvement.

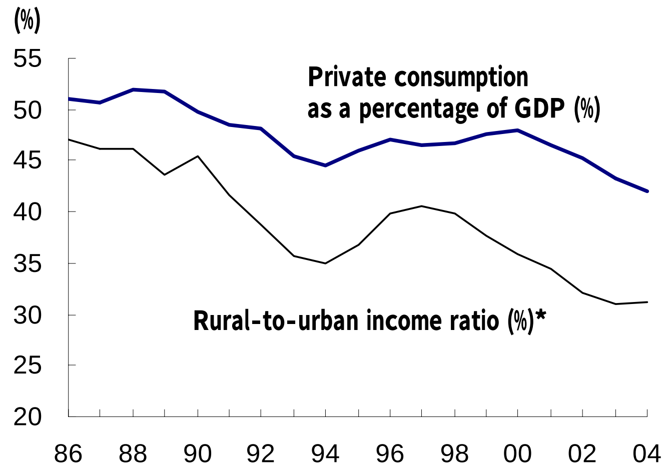
2.3 Correcting intra-regional income gaps through movement of capital and labor

In addition to supply-side considerations, the demand side is required to provide a market big enough to absorb the increasing production. Since China's rapidly expanding exports (particularly exports of labor-intensive products) are giving rise to trade frictions, economic growth needs to be supported by domestic demand. This in turn requires correcting the very large intra-regional income gaps, which currently restrict the expansion of consumption.

In an effort to do away with the harmful effects accompanying the egalitarianism that prevailed in the era of the planned economy, Deng Xiaoping pushed forward the reform and open-door policy in the late 1970s, giving priority to efficiency over equality under the slogan of "allowing some regions and people to get rich first." A quarter of a century later, people's life has generally improved, but income disparities have widened sharply. Particularly noteworthy is the fact that, amid the widening income gaps, some of the wealthy are consuming more high-ticket items while farmers who account for the majority of the population are suffering from sluggish income growth. Such situation prevents overall consumption from briskly rising.

In fact, the ratio of private consumption to China's national GDP has been on a downward trend in conjunction with the widening income gaps between rural and urban areas (see Fig. 2). The ratio stood at 43.2% in 2003, a level much lower than about 60% in advanced nations such as Japan, and the lowest of all Asian nations. The low propensity to consume means not only that consumption generates a weaker effect to push up GDP but also that income increase generated by greater consumption exercises a weaker indirect effect to induce further consumption (the so-called multiplier effect).

Figure 2. Propensity to Consume Falling as Income Disparity Widens



* Per capita disposable income and per capita net income are used to measure urban and rural incomes, respectively.
Source: Compiled from *China Statistical Abstract 2005.*

Boosting domestic demand by increasing consumption requires the correction of intra-regional income gaps, which in turn requires labor to move from low-income areas to high-income areas and capital to move in the opposite direction.

If barriers such as family register restrictions that limit labor movement are removed, labor will flow from low-wage inland and rural areas to industrialized coastal or urban areas, and will cause wage levels to be more even. Labor force movement will be a factor in reducing intra-regional income gaps if we also take into consideration migrant workers' remittances to their families. Even now there is a massive movement of the labor force from rural areas to urban areas in search of job opportunities and better income despite many existing barriers including the family register system.

A survey compiled in March 2004 by the National Rural Fixed-Point Observation Office, Ministry of Agriculture, shows that currently there are as many as 98.2 million migrant workers. Their average annual income is 5,279 yuan (their aggregate income totals 518.4 billion yuan, equivalent to about 5% of GDP), of which 3,768 yuan are remitted to their homes. Their total remittances amount to 370.0 billion yuan. These remittances account for an important part of rural income.

On the other hand, as for capital movement, the so-called "flying-geese pattern" will provide a good model for China to follow. This pattern shows that the Asian economic development first started in Japan, then spread across NIES (newly industrializing economies) and ASEAN (Association of Southeast Asian Nations), and further on to China. The "flying-geese pattern" depicts a division of labor according to comparative advantage among Asian countries at different levels of economic development. Front-runners and latecomers each aggressively push forward industrial restructuring by combining the development of new industries with the transfer of declining industries overseas, and this acts as the driving force behind the dynamic growth of the whole region. The flying-geese pattern has heretofore been discussed on a nation-versus-nation basis. For a huge country like China, however, the pattern may be better applied to eastern China, central China and western China, which are at considerably different stages of development. Over the last twenty years, coastal areas (eastern China) led by Shanghai and Guangdong have achieved high growth leveraged by production and export of labor-intensive products. This will eventually result in higher land prices and wages, and cause labor-intensive industries to cease being competitive there. Then, not only foreign firms, but also Chinese firms, will be forced to transfer their production base to other regions in search of cheaper labor and land. They will focus their attention on inland regions comprising of central and western China as new destinations for investment.

To realize development by this domestic version of the flying-geese pattern, China is pressing ahead with "Western Development" centered on the improvement of investment environments in the inland regions. Central to the development are mega projects such as natural resources transportation (transportation of gas and electricity produced in the west to the east), and improvement or construction of airports and railways. Improvement of infrastructures in inland regions by means of these mega projects will enable the regions to emerge, in the not-too-distant future, as new destinations for investment at least for labor-intensive industries. This will prove to be conducive to the building of production networks to capitalize on intra-regional complementary relationships. Movement of capital to less-developed regions will speed up their development, and, consequently, help narrow the intra-regional income gaps.

3. What China will be like in the 5 and 10 years to come

As a huge country with a 1.3 billion population, China promises much room for growth. China has become widely known as “the factory of the world” that capitalizes on plentiful labor. To become “the market of the world” China needs to have demand grow in its domestic market. To this end, China needs to improve market infrastructures including the protection of property rights, correct income gaps, enhance production efficiency, and upgrade the industrial structure.

China grew at an average rate of 8.1% a year over the five years between 1999 and 2003, much higher than Japan’s 0.7% over the same period. Assuming these growth rates will continue in the future, Japan’s GDP, which in 2003 was three times as much as that of China ($1.41 trillion for China against the $4.28 trillion of Japan), will be overtaken and passed by China in 2019. Certainly the advantages enjoyed by a latecomer economy will gradually wane, and maintaining an annual average growth rate of 8% will become more difficult. China may expect, however, to maintain a relatively high growth rate as globalization prompts Chinese enterprises to improve their productivity, while market discipline is established under the rule of law.

On the other hand, the task of raising the people’s income level has a long way to go. Even when China’s GDP catches up with Japan, on a per capita basis, its will still be one-tenth that of Japan because of its approximately tenfold population. Furthermore, as mentioned earlier, the growth in national consumption will be constrained by the very large income gaps within China.

The Chinese authorities are not averting their eyes from these problems. “Building an all-round well-off society,” the slogan currently put forth by China, states as clear objectives higher income levels and a more even income distribution. An “all-round well-off society,” as used herein means a society where people can live more comfortably under more equal income distribution than at the ”initial stage of a well-off stage” supposedly achieved in 2000. Furthermore, “the decision on some issues regarding the improvement of the socialist market economic system,” adopted at the 3rd plenary session of the 16th Central Committee of the Chinese Communist Party held in October 2003, puts forth the policy, which later came to be called in China the “scientific view of development”: put people first, establish a comprehensive, coordinated and sustainable concept of development, and promote comprehensive economic, social and human development. As its main feature, the policy seeks to quadruple China’s GDP between 2000 and 2020, while keeping attentive to international relations and the natural environment as well as to the weak through measures such as correction of income gaps in favor of low-income people and less-developed regions and strengthening safety nets.

3.1 Standard scenario (probability 70%): correction of income gaps slowly advances bringing China closer to “the market of the world”

Market competition under international rules will increase corporate productivity.
Economic growth will be slow in spreading to inland regions. Income gaps will be corrected to a certain degree, but will remain large.
In the world's total imports, China will account for 7.2% in 2010, rising to 8.9% in 2015.

A standard assumption on China's future is that China will achieve certain progress toward the objective of building an "all-round well-off society." Upon joining the WTO, China announced its commitment to advance the market economic system under rules that conform to international standards, rather than to manage its economy under the government's traditional, discretionary control. Therefore, sound market infrastructures will be created in accordance with the commitment.

For instance, foreign firms will be allowed to enter Chinese markets as seen in the liberalized scope of banking operations, which will serve as priming water. At the same time, state-owned firms and private firms will be treated equally, giving private firms more room to expand. The entry of foreign firms and the growth of private firms will urge the easing of various regulations on competition that have so far favored state-owned firms. Interest deregulation put into effect in October 2004 will promote lending to private firms at rates of interest consistent with their lending risks. As the scope of liberalized operations widens, in more phases and cases state-owned firms will compete with private or foreign firms, and local governments will have a smaller sphere in which to arbitrarily manipulate laws or interfere with private firms' activities using its license/permit-granting power. In addition to the establishment of rules on competition, the base is thus laid for all firms to compete under clear and fair rules. All this will contribute to more efficient allocation of resources. Deregulation of interest rates, for instance, will shut off lending to poorly productive firms, and will cause banks to act more selectively in favor of efficient firms. The easing of entry barriers and the regulation of competition will likely compel Chinese firms to improve their productivity under the pressure of competition.

On the other hand, intra-regional gaps may remain large over a five-to-ten-year span, partly because political measures to produce projected effects aimed at intra-regional gap correction through redistribution of tax revenue or any other measure will take more time to show their effects. Although labor will move more freely, capital will continue to be concentrated in coastal or urban areas equipped with adequate infrastructural facilities, and the fruits of the economic growth will not fully spread across to inland regions.

Industrial upgrading is not likely to advance considerably because the average technical level of workers will not rise much over the span. A small number of Chinese companies may acquire their own technology or establish their own brands in international markets. Generally speaking, however, better efficiency may yet be enjoyed by a labor-intensive industry that uses the labor force coming from inland regions. As the technological capabilities of domestic firms continue to advance, they will start to care more about the protection of intellectual property rights. However, assuming that industrial upgrading will not advance much, we may safely presume that China will not go beyond the fulfillment of its commitment.

Although industrial upgrading and income gap correction will not advance much over the next 5 to 10 years, people's income level will continue to increase with the improvement of market infrastructures and production efficiency. Consequently, China will gradually move toward "the market of the world." Provided that other countries' economic growth continues on the recent trend and China can successfully steer its growth toward the direction designed by the present policies, its share in the world's imports will likely rise to around 7.2% and 8.9% in 2010 and 2015, respectively. China's imports, which were more or less equal to those of Japan in 2003, will be about 1.77 times and 2.51 times those of Japan in 2010 and 2015, respectively. When compared with the U.S., China's imports, which amounted to 31.7% of the U.S. imports in 2003, will rise to 45.1% and further to 58.0% of the same in 2010 and 2015, respectively, narrowing the differences.

3.2 Optimistic scenario (probability 20%): income level considerably improved making China "the market of the world" earlier

Improved market infrastructures will enable private firms to grow considerably and more foreign companies to enter Chinese markets, thus contributing to the further improvement of corporate productivity.
Capital movement to inland regions will get into full swing and will increase local income, thereby correcting income gaps.
China's share in the world's imports will rise to 9.2% and 13.6% in 2010 and 2015, respectively.

On the other hand, easing of entry barriers and regulations on competition, as well as improvement of market infrastructures under international rules, will likely lead to the more-than-expected growth of private firms. Provided that domestic firms' average technological level rises beyond expectation, and that there appear many firms equipped with advanced technologies and brands strong enough to survive international competition, China will devote more effort to protect their intellectual property rights. Then, foreign firms, which are hesitant for fear of rampant pirated versions, will find China to be a more attractive place to invest. Owners and managers of private firms that have now greater economic power will have a stronger political voice. Such new environment will cause applicable laws to be enacted or modified accordingly and the government to become less discretionary or interfering, and thus encourage more private or foreign firms to enter Chinese markets. The entry of private or foreign firms will intensify competition, and lead to more efficient allocation of resources through a shakeout process such as privatization or bankruptcy of state-owned enterprises or their acquisition by private firms. This scenario will improve the private firms' productivity more than in the standard scenario, and remarkably improve their quality in terms of technical and marketing capabilities.

Furthermore, if the coastal regions become competitive in capital-intensive industries as their technological capabilities improve, the opportunity cost of operating labor-intensive industries in coastal regions will increase, prompting them to move inland. This will help raise the economic strength and income levels of the inland areas, where local governments will also have more tax revenue to improve infrastructures.

Thus, in an environment where the growth of private firms and the progressing market economic system generate a synergistic effect, market competition will be conducive to greater productivity and higher-level consumption, and help China become "the market of the world" earlier. At such time, China's share in the world's imports will rise to around 9.2% and 13.6% in 2010 and 2015, respectively. China's imports in 2010 and 2015 will be about 2.27 and 3.87 times those of Japan and 58.0% and 89.2% of the United States', respectively.

3.3 Pessimistic scenario (probability 10%): market will expand only slowly due to vested interest groups' resistance toward reform

Vested interest groups will interfere with deregulation that imposes intense competition on state-owned enterprises, causing delays in improving market infrastructures and impeding more efficient allocation of resources.
Corporate productivity will not improve and the correction of intra-regional gaps will be delayed.
China's share in the world's imports will be 5.5% in 2010 and 5.6% in 2015, not much different from it is today.

Building an "all-round well-off society," however, is not necessarily desirable for vested interest groups who are the beneficiaries of the existing income gaps. The establishment of the rule of law would render difficult illegal acts such as the diversion of state-owned assets, and the advancement of a market economy and globalization may even put into jeopardy the existence of state-owned enterprises. Furthermore, their political voice is far from being weak at this moment. It is difficult, therefore, to avoid political frictions in building an "all-round well-off society," and if the vested interest groups exercise their powerful political clout seeking to secure their own interests, attainment of the objectives will become remote.

For instance, state-owned firms that lack any motivation for efficient management will find any easing of entry barriers or deregulation of competition very harmful. Furthermore, if money-lending state-owned enterprises are brought to the verge of extinction, vested interest groups such as managers of state-owned enterprises will no longer be able to engage in the improper pursuit of profit by use of power, and, worse yet, they may be held responsible for the poor performance of the enterprises. It is very likely, therefore, that these groups will interfere with deregulation that seeks to enhance competition and further market opening. At local levels, vested interest groups will also continue to arbitrarily manipulate laws against, or interfere with, private enterprises contrary to the will of the central government.

Protection of intellectual property rights is also not desirable for those who want to copy from others instead of investing their own money in research and development. In case the vested interest groups continue to interfere visibly or invisibly, it will delay the establishment of market infrastructures and impede efficient resources allocation. In such circumstances, the improvement of firms' productivity will be held back, industrial upgrading will go no further, and the economy will grow more slowly. Worse yet, such groups will cause a delay in intra-regional gaps correction, as they basically do not want the income redistribution policy to be implemented, resulting in the slower expansion of markets in China.

In case such resistance by vested interest groups impedes reform and thus economic growth, China's share in the world's imports will be about 5.5% and 5.6% in 2010 and 2015, respectively, not much different from its current level. China's imports will reach 1.35 and 1.59 times those of Japan in 2010 and 2015, respectively, and China's imports will amount to 34.5% and 36.6% of the U.S. imports in 2010 and 2015, respectively, changing little from the 31.7% recorded in 2003.