

## Chapter 3 Chinese market five and ten years hence will greatly widen with the growth of the middle class

### [Key Points]

1. An outlook for the relationship between China's political-social changes and the market shows that the middle class growth will lead to a rising demand for the liberalization of economic activities and further deregulation. Democratization will not advance so rapidly, but a direct election is likely to be held on a trial basis in some of the smaller cities toward 2015. The growing middle class will contribute to the expansion of the market size; yet market transparency will advance slowly hindered by protectionism clung to by local governments.
2. Government's attitude toward pro-democracy movements will lead to either top-down democratization declared by political leaders before the middle class has grown enough, or suppression of democratization movements by force. Either case will lead to temporary confusion, but repression of democratization will cause immeasurable adverse effects on the world economy.
3. All foreign-owned firms including Japanese companies should make the most of the middle class growth as a business opportunity while dispassionately addressing any rise of nationalism.

### 1. China's triangular relationship between politics, society and the market, and changes therein

The relationship between politics, society and the market in present-day China has changed over two utterly different phases. Until the end of the 1970s, politics was in complete control of the others; society was strictly controlled, supervised and overseen by communist organizations along the communist party line, and the general public had almost no freedom of movement or speech. On the economic front, almost all production activities, with the exception of a few rural "privately held plots" (kitchen gardens) and free markets, distribution and sales were controlled by a highly centralized government under a planned economic system.

Why was the reform and open market policy initiated by Deng Xiaoping called "the second revolution" in China? The reason is because only in 20-odd years the policy brought about structural change across almost all areas of Chinese society starting in the economic area, and

imposed a revolutionary change on the triangular relationship between politics, society and the market. The triangular relationship has changed from one of politics governing the other two to one of interlocking where the three parties interact with and influence each other. It goes without saying that, to this day, politics that embodies the guidance of the Chinese Communist Party continues to occupy a leading position among the three and exerts a decisive influence. On the other hand, however, it is undeniable that the following changes have come about.

(1) Both society and the economy are becoming increasingly autonomous with respect to politics. Especially after 2000, they may be deemed as dominated by a part that is not subject to politics' control any more.

(2) Not only have society and the market started to move autonomously, but they also work counteractively to politics urging it to change as well. Former President Jiang Zemin's "three-representative theory" and Hu Jintao's taking up the reform of the party toward democratization at the 4th plenary meeting of the 16th-term Central Committee are both attributed in good part to the changes occurring in Chinese society and its economy.<sup>1</sup>

This chapter is not aimed at the theoretical examination of the triangular relationship, but at seeing how the relationship will affect market creation. This triangular relationship has its base expressed as politics' influence on society, but here the writer wishes to review the relationship chiefly to see how changes occurring in politics and society are affecting the economy and the market, what possibility will be brought about in the future by the triangular relationship, and, especially, what market potential will be created by it in favor of Japanese firms that seek greater business opportunities in China.

Principally, we can find three major currents in the changes that have occurred in the triangular relationship, particularly in respect to the impact that politics and society have produced on the economy and the market since the 3rd plenary meeting of the 11th-term Central Committee held at the end of 1978.

### 1.1 Politics' role has drastically changed relative to the economy

In the era of Mao Zedong, economic activities were almost totally controlled by the communist party either directly or indirectly through the government by the following three means.

(1) The party drew up the guiding policies and the party line including for the economic area, and restricted the free will as expressed by the economic activities.

(2) The government carried out economic activities "on behalf of" all sectors and industries, deciding on prices of products and factors of production, totally ignoring the market mechanism. The government also directly allocated resources and formed the mechanism of a highly centralized planned economy. The government was the owner of a great majority of social assets and directly

intervened in and controlled the process of production, playing the role of responsible management.

(3) The party had total control of personnel affairs. The party had the power to appoint all executives in government sectors, regional and local administrative bodies, and state-owned enterprises as well as collectively-managed enterprises.

Then, in the era of Deng Xiaoping, the government and the party began to refrain from exercising excessive intervention and interference. In 1992, the government put forth a new direction of political regime reform “aiming to establish the mechanism of a socialist market economy,” after which the government’s role considerably changed relative to the economic activities. In respect to (1) and (3) above, the economic function currently performed by the Chinese government is defined as the following five<sup>2</sup>:

- (i) Enact economic laws and regulations, and oversee their implementation;
- (ii) Draw up strategies and guiding policies for economic and social development; organize their implementation process; and coordinate inter-regional, inter-sectoral and inter-company economic relations. Strategies brought forward such as “Western Development” and “Northeast Industrialization” give directions to the development of economic activities while the five-year plans, originally intended to control economic activities, now serve to provide predicted objectives and the guiding direction for economic activities;
- (iii) Direct development and execution of priority projects such as natural resources development that span different sectors and regions; for instance, organization, execution and operation of mega projects such as “Three Gorges Dam” and “Supply of southern water to the north”;
- (iv) Control the macroeconomy by monetary, fiscal or other means, and achieve industrial development objectives by means of industrial policies. Some of such activities are the aggressive fiscal policies such as expansion of public investment carried out by the then Prime Minister Zhu Rongji to revitalize the economy and cope with the deflationary economic trend of the late 1990s, and the policy adopted in 2004 to put a curb on the overheated economy;
- (v) Manage economic and trade relationships with the outside world; for instance, decision of preferential treatment designed to attract foreign investment or establishment of special economic zones; or carrying out negotiations for joining the WTO and the ensuing fulfillment of the commitments as well as performing the role of a supervisor and coordinator of the relations with foreign countries (including business firms).

On the other hand, the power to manage personnel affairs of state-owned firms is still kept by the party and the government; however, “state-owned” firms are very different from what “state-run” firms used to be, and their share in the nation’s total economic activities has dropped to below 30% from the formerly held 90% share. Consequently, the possibility of the party and the government to exert influence over the overall economic situation by means of their power to

control personnel has been considerably reduced.

Table 1 below gives a summary of the changes in the role of politics relative to the economy between the era of Mao Zedong and years after 2000.

Table 1. How politics' role has changed relative to the economy in China

	In the Era of Mao Zedong	After 2000
Method of control	Drawing up the guiding policy and party line and enforcing complete implementation.	Legislation on economic matters and overseeing the implementation of laws.
Method of involvement	Party and government carry out economic activities on behalf of all sectors and industries.	Principally, coordination of regions, companies and other economic units as well as "window guidance."
Means of involvement	Unilateral and direct administrative order.	Administrative means continue, but coordination is made through monetary and fiscal measures; both direct and indirect means are employed.
Personnel affairs	Party has total control over personnel affairs of state-owned firms that are actors of economic activities.	Although the majority of enterprises are privatized, the party retains the power to make final decisions on personnel affairs, but it also follows the process of considering public opinion and elections.

(Prepared by the writer.)

The above changes in the governmental function mean that now more factors facilitate market creation such as an elementary market mechanism established, a legal and fair framework governing the market, and circumvention of waves of economic cycles. Despite the persisting infringement of intellectual property rights, breaches of contracts, corruption and other problems, we may conclude that China has created a promising and attractive market, albeit immature, in rudimentary form.

## 1.2 Appearance of the middle class opens new possibilities for the economy and the market

In the era of Deng Xiaoping, the triangular relationship between politics, society and the market became an increasingly interlocking relationship where the three parties interact with each factor

more closely. Politics gradually freed the economy from its constraints and eased its control over society to a certain degree, while the high economic growth brought about continuous change in the social structure and public awareness. In the course of such process, the structure and awareness also underwent autonomous development and change.

A pluralistic tendency of Chinese society has surfaced in recent years. In the era of Mao Zedong, the whole nation, except for “enemies of classes,” was divided into three groups - working, agrarian, and intellectual; however, such past grouping by class and stratum became meaningless under the extended economic reform policy promoted by Deng Xiaoping. Take the agrarian class, for instance. They are now classified into more than ten categories such as full-time farmers, part-time farmers, farmer-born city dwellers, rural entrepreneurs, employees of rural firms, rural management class, and others.

The economic development has pushed up national living standards, and has given birth to the middle class, generally in coastal and urban areas, as well as wider income gaps. The middle class is made up of “real middle class” and “self-acknowledged middle class.” The former is represented by a middle class backed up by actual income levels. As of 2003, they accounted for some 17% of the entire population, or 200 million people, while an estimated 200-250 million people “consider themselves middle-class” as they feel that “their income level has risen considerably higher than other people or their past level although not to a really middle-class level.” This is an epoch-making change in which China’s dual social structure converges into a middle class for the first time in its history and serves as an important base for promoting political democratization. The change also serves as a factor to push the economy and the market toward new attitudes and activities that will generate new possibilities.

The high economic growth has brought about another “first time in history” phenomenon of overproduction, or a situation where supply exceeds demand. In the days of supply shortage, consumers had no way to defend themselves, but in and after the mid-1990s consumers have become free to choose products, which situation has forced sellers to provide better service to entice consumers to buy their products. The process of such change has caused consciousness to burgeon among consumers concerning the protection of their rights and the social system to gradually implement a mechanism (laws, complaint windows, and the like) for the protection of such rights. The general public has moreover begun to claim rights to “sunlight,” “scenery,” “portrait,” and others. Nationalism is also growing on the back of such sprouting right-consciousness. Although such nationalism requires careful attention, the foregoing developments indicate the emergence of social factors that place the government in a relative position as well as the process of China shifting from an “authoritarian society” to a civil society. Consequently, the developments serve as fundamental factors that substantially transform China’s

traditional economic and consumption structure. They seem to show that in the future the Chinese economy and market will be driven principally by the middle class.

### 1.3 Interaction among the three parties will further the open-door policy

To further promote its economic growth the Chinese government has been making efforts to bring in foreign capital and increase exports. Such efforts mean that the Chinese economy is now integrated into the world economy and is bound by international rules. It is no longer influenced by domestic political developments. Various analyses have been conducted as to the motives that had made China decide to join the WTO. One of the most important causes should have been the increasing necessity for China to give greater importance to external economic relations to sustain the development of its domestic economy. "The accession to the WTO was also intended to reform the outdated system of the domestic economy taking advantage of external pressure," attested later by Long Yong Tu, who represented China in talks on the accession.<sup>3</sup>

After joining the WTO, China was never free from the other members' doubts about its adherence to WTO rules and commitments. Although not just a few problems remain to be solved yet, within and without the country people appreciate that China has basically kept its promise and substantially promoted the implementation of international rules. At the "WTO and China - Beijing International Forum 2004" celebrated in November 2004, Wang Qin Hua, director of the Industrial Damage Investigation Division, Ministry of Commerce of China, made public that, in general terms, following its entry into the WTO China lowered its import duties from 15.6% in 2000 to 10.6% in 2004 and expects to further reduce them to 10.1% in 2005 (9.3% being applicable to industrial products on average). Furthermore, over the last three years all government sectors combined have abolished or revised more than 2,300 laws and regulations that were in conflict with WTO rules, and further amended more than 190,000 regional or local laws and regulations.<sup>4</sup>

Prompted by the current of the Information Age, China now has close to 100 million users of the Internet. Thus, the information gap that existed between China and foreign countries has been substantially filled up. This is another factor that guarantees the closer proximity of Chinese society and market to the world in the future.

Foreign-owned firms established in China used to enjoy "preferential treatment" not accessible to firms of national capital, but such preferential treatment has been unified into "national treatment." "Preferential treatment," which appeared to be especially favorable to foreign capital, was designed to make investment conditions attractive for foreign capital to promote their investment in China, because at that time the whole country had no infrastructures to receive foreign capital or any applicable rules in place. In recent years, however, China has improved investment environments to make up for gradually lessening the "preferential treatment"; and

further, China has opened its domestic markets to foreign capital. With its entry into the WTO and the emergence of domestic firms, the Chinese government is no longer able to put into practice “discriminatory” policies favoring certain companies. In that sense, the shift to “national treatment” should not be considered as anything negative, but as an opportunity for developing new possibilities in the Chinese market.

The three changes explained above began around the mid-1980s. Just like a plane’s takeoff, the changes commenced slowly. After that, they have continued accelerating and have reached such a critical point in recent years that the “China” plane has taken off at long last. And now, all over the world people talk about the possibility of China growing into a “superpower of production” or an “economic superpower.”

The three changes brought about by China’s sweeping structural reforms mean that the reform and open market policy is now irreversible, and that politics, society and the market will go on changing in a more interlocked relationship, thereby generating new opportunities and possibilities for market creation.

## 2. How new political and social changes will affect market creation

Changes on the economic and political fronts in China have further advanced in recent years. Such changes have been prompted by the high economic growth that has reached the takeoff phase. Rapid changes that have appeared in various sectors of the economy have been causing a greater impact on politics and society. In 2001, for the first time Chinese students returning home from studying abroad were more numerous than those going out. The same phenomenon was also seen in Japan, Korea and Taiwan when they entered a high-growth period, respectively. It also corresponds to a period in which social changes take place in the most dramatic manner.

It should be noted that such accelerating changes are closely related to the appearance of new leadership led by Hu Jintao. President Hu Jintao and Prime Minister Wen Jiabao were both born in 1942. The new-born leadership does not merely mean substantial rejuvenation of the faces that represent China and the birth of new leaders that are capable of energetically addressing piled up problems. Different from the core members of the former leadership (Jiang Zemin and Li Peng, who mostly lived in big cities in coastal areas), the majority of the new leadership members lived and worked for many years in rural or inland areas. Hu Jintao and Wen Jiabao, in particular, worked in impoverished Gansu Province for over ten years after graduating from university, and know very well the problems lying at the bottom of the social pyramid as well as what people living there feel and are not satisfied with. Their knowledge about such problems is precisely the factor lying behind the new leadership’s stepped-up efforts to address political and social reforms.

Hu Jintao assumed the office of the secretary general of the party at the 16th party meeting held

in November 2002, then became president of the nation at the 10th National People's Congress (equivalent to a parliament) held in March 2003, and successively chairman of the military committee of the communist party at the 4th plenary meeting of the 16th-term Central Committee held in September 2004. Thus, he took full power. From around such time, China's political and social scenes began seeing new developments and changes coming up in succession. The writer wishes to examine such new changes from the perspective of market creation.

## 2.1 Improving legal systems and promoting rule by law

At the 2nd plenary meeting of the 10th National People's Congress held in March 2004, the constitution was amended as many articles and expressions therein were modified. In matters related to the economy and the market, the state's fundamental task was defined as "to dedicate all its efforts toward the building of a modern socialism along the way of China's distinctive socialism," and it was stated that "the state will protect lawful rights and interests of nonpublic economies such as individual and privately-managed economies," and, further, that "citizen's lawful private property is inviolable." It was also declared "the state will protect and respect human rights." These are important revisions of the policy.

The constitutional amendment made this time will significantly affect the future of China in many ways, some academics point out<sup>5</sup>, because the amendment: marked an important step toward "a law-governed nation" under a government that acts within an institutional, legal framework; established respect for and protection of human rights as the nation's fundamental principle; embodied the "people-oriented" scientific perspective on development and defined the solution of the problems and frictions occurring in the period of social transition as objectives to be pursued by all levels of government; upgraded the mechanism of the socialist market economy and the legal environment to build a "somewhat affluent society" upon nationwide efforts; and furthered a sound legal system, dealt with the relations between the center and regions, between the state and society, and between the government and the people in a balanced way, and embodied "people's-interests-first principle" in all legislation, and so forth.

The legal system improvement including constitutional amendments is being pushed forth in all areas. Over the five years to 2003, the National People's Congress adopted more than 100 important laws. Now we may say that the Chinese legal system has been almost completely built if we take into consideration administrative laws and regulations enacted by the State Council as well as local laws enacted by local congresses. Of all those legal improvements, legislation activities relating to the economy - except for constitutional amendments - were conducted principally in the following four areas.

(1) Improvement of the Civil Code that governs civil and commercial affairs (adoption of contract

law, agricultural land contract law, etc.) and improvement of the Commercial Code (revision of patent law, trademark law and copyright laws; adoption of securities law, public tender law, trust law, etc.).

(2) Improvement of economic laws to place control of the state's economic activities under defined legal rules as seen in the revision of the product quality law, accounting law, tax revenue and tax collection law; and enactment of the land administration law, grassland law, water law, etc.

(3) Improvement of administrative laws that govern the state's administrative control activities such as enactment or revision of the administrative review law, population and birth planning law, advanced education law, drug control law, air pollution prevention and remedy law, marine environment protection law, and administrative permission law.

(4) Improvement of social laws related to labor, social security and welfare (revision of the labor union law and adoption of safe production law, occupational disease prevention and treatment law, etc.).

Generally speaking, improvement of the legal system will prove to be positive principally to economic development and market creation. The constitution as amended so far will legally protect the market economy and private property, make the political system irreversible, and deprive any artificial change of law or policies or political intervention in the market or individual interests of all legal grounds. The constitutional amendment and revision/enactment of many laws may also be deemed as having consolidated the legal basis so that China may more faithfully adhere to WTO rules and other rules practiced in the international community, become "fused" to the world economy overcoming differences of political systems, and promote frameworks for economic integration, such as free trade agreements (FTAs), with foreign countries.

Promotion of the legal system at all sector levels is of particular significance in putting the government's policy decisions and activities within a legal, transparent framework. At an informal gathering and talks held on March 6, 2004 with Heilongjiang Province representatives participating in the National People's Congress, Prime Minister Wen Jiabao brought forward the "let the law govern the administration" principle, and gave direction to the reform now underway as expressed particularly by ideas such as "lawful administration" based on law, "reasonable administration" that conforms to equality and fairness, compliance with legal procedures, efficiency improvement, and transparent responsibility of the administration.<sup>6</sup> In April of the same year, the State Council promulgated "Guidelines for promoting the overall implementation of a law-governed administration," and presented a vision as expressed in "realize a law-abiding government over the next ten years."<sup>7</sup>

If Wen Jiabao's forecast turns out to be true, China will have built by 2015 a framework of a law-abiding nation guided by the motto of fairness and equality. Foreign firms have long suffered

from the administration's inconstant policies, which are virtually announced in the morning only to be changed in the evening, or vary from one region to another. To such foreign firms, the Chinese government's efforts to put a legal framework in place would mean that a certain level of transparency and fairness will be provided to the laws and policies on which they rely for entry into the Chinese market and business operations therein. The efforts will also provide them with access to legal bases in case any trouble compels them to file a lawsuit, or seek amicable settlement or improvement. Marubeni Corporation is the first to make use of such legal framework. By entering into a tie-up with China University of Political Science and Law that has a good record and accomplishments in jurisprudence, Marubeni receives from the university, in exchange for certain financial support, the latest information on improvements in the legal system and interpretations thereof as well as advice on the use of such information.<sup>8</sup>

## 2.2 Shift to "We'll be rich together" theory and "friendly to the weak" policy

The political report presented at the 16th party meeting held in November 2002 put forth a nonbinding challenge of "Let's build a somewhat affluent society nationwide by 2020." The shift indicates that the government has changed from the growth-oriented policy in favor of certain specific areas to a policy favoring overall balance, or from "Be the first to be rich" theory to "We'll be rich together" theory.

Following the announced shift, at the 3rd plenary meeting of the 16th-term Central Committee held in the autumn of 2003, the party proposed, "We will maintain the people-oriented policy, establish a comprehensive, cooperative and sustainable perspective on development, and promote overall development of the economic society and people," and officially announced the scientific perspective on development that gives consideration to "the balance between cities and rural areas, the balance between regions, the balance between the economic development and social development, the balance between man and nature, and the balance between internal development and market opening."

One of the core contents of the "scientific perspective on development" lies in the correction of various gaps and disparities. Prime Minister Wen Jiabao stated in his first speech that brought forward the perspective: "While our economy has kept growing, not just a few contradictions and problems have piled up. The main problems are the ever-widening gaps between cities and rural areas, between regions, and between citizens relative to income; and increasing pressure on employment and social security, delayed development of social projects such as education, health and culture, and deepening contradictions between and among the growing population and economy, the ecology and natural resources. (snip). Precisely at this important phase of development, a scientific perspective on development is required so as to properly maintain the

balance of various gaps.”<sup>9</sup> About the proposed scientific perspective on development, Hu Angang, a renowned economist, wrote: “It means that the Be-the-first-to-be-rich theory brought forward by Deng Xiaoping after the 3rd plenary meeting of the 1978 Central Committee has been officially changed to the proposal and pursuit of the We’ll-be-rich-together theory, marking a great change in the philosophy that guides China’s reform and open market policy.”<sup>10</sup>

The “We’ll be rich together” theory has led to a series of gap correction measures: high-income earners are more closely investigated for taxation purposes<sup>11</sup>; super-rich who ranked in the *Forbes* magazine were successively subjected to investigation on suspicion of tax evasion and the like; and top-class actress Liu Xiaoqing was also put in jail for tax dodging. At the same time, progressive tax rates and inheritance tax were thoroughly put into effect for more extensive wealth redistribution.

The family register system that puts restrictions on farmers moving to urban areas has been in effect since 1958. In 2002, the central government promised to conduct a sweeping revision of the system within the next five years. Many regions have already partially eased the restriction. In August 2004, Hubei Province took the initiative of eliminating the distinction between “agricultural register” and “non-agricultural register,” unifying them into the “Hubei Province resident register.” The new register system permits anyone to freely move to any city within the province provided that he/she “has a lawful fixed domicile and a relatively stable job or a lawful income source” (except for Wuhan, which will be liberalized by 2006).<sup>12</sup>

For low-income people, many support measures have been announced. In 2003, the total amount of subsidy for people “living below urban resident’s subsistence level” established by the authorities was doubled to 9.2 billion yuan from the previous year’s 4.6 billion yuan. In 2004, the special agricultural product tax was eliminated. Prime Minister Wen Jiabao made a public commitment to completely lift agricultural taxes within the next five years. On the other hand, the government has promoted the reform of the agricultural taxation systems in an effort to lessen the farmers’ burden. The government also increased by more than 20% fiscal expenditure destined to building infrastructures in rural areas such as water supply facilities. In 2004, the government contributed a subsidy of 10 billion yuan to foodstuff-producing farmers in addition to a raise in foodstuff procurement prices.<sup>13</sup>

One element that often weighs on farmers has been attributed to the existence of village- or town-based “rural enterprises” and excessive bureaucrats who live on the charges collected from farmers. Mergers and closures of “rural enterprises” went into full swing in 2004, prompted by relevant notices issued at the beginning of the year. By the end of September, 864 rural enterprises were closed and 86,400 bureaucrat jobs were cut in 20 provinces and autonomous regions.<sup>14</sup>

Such gap correction measures are already affecting foreign firms. It happened that in and after

the spring of 2004, coastal areas including Guangdong begun to suffer a shortage of workers migrating from inland rural areas by the hundreds of thousands, because farmers find it preferable to stay and earn what they can in their village, enjoying the financial support offered by the authorities, compared to cheaply paid tough work in coastal areas. Thus, in November of the same year, Guangdong Province raised the minimum wage level by 20% from 510 yuan to 684 yuan in an effort to attract migrant workers.

The promotion of the “We’ll be rich together” theory is presumed to affect the market in the following ways:

- (1) The extremely low labor cost prevalent in coastal areas will be raised; which, despite China’s still lower labor cost than in most third world countries, will likely accelerate foreign investment’s shift from labor-intensive industries focused on cheap labor to higher-added value industries;
- (2) Income growth in rural and inland areas will expand local markets to a certain level. Once main markets for electric/electronic products become saturated in urban and coastal areas, they will move to rural and inland areas; however, local markets found there are principally for comparatively low-priced articles of utility - where foreign-owned firms are in a disadvantageous position - rather than high-end items. How many foreign firms will be able to recover their market share depends upon what efforts they will make in the future. Rural areas will promote land merger or concentration, or formation of agricultural cooperatives in the Japanese fashion, which development will lead to a sharp increase in sales of small and medium agricultural machines. Also changes in production or management methods will require the distribution system in rural areas to be upgraded and transport-agricultural vehicles (so far principally small-size tractors) to be massively renewed. How to respond to such new needs will be an issue that all foreign-owned firms must urgently address.

### **2.3 Middle class influence will become stronger**

Since 2000, many studies have been made on the influence produced by the expanding middle class on China’s politics and economy. The growing class has become a social current that is no longer negligible. It is now believed to influence consumption trends, public awareness, and the future of politics. A research conducted by the Chinese Academy of Social Sciences shows that the middle-income class (households that possess property worth 150,000-300,000 yuan) is expanding 1% each year. The class, which accounted for 15% of the total population in 1999, now reaches 19% in 2003.<sup>15</sup> Combined with “self-acknowledged middle class,” the middle class of Chinese society now accounts for more than 40% of the total population. The study reveals that China, which used to be a traditional dual society, is now undergoing serious structural change.

The effects can be seen in the rapid changes occurring in the consumption structure and

consumer sentiment. Now that the middle class has become core consumers, the standard applied in considering a purchase has shifted from “practical utility, low price and durability” to “good design, famous brand, pollution-free and environment-friendly.” For instance, a recent hearing survey conducted on furniture markets in urban areas revealed that in recent years the most influential judgment standard employed when purchasing furniture is “whether or not the paint or material contains any substance harmful to humans.” On the other hand, foreign brand-name goods are selling quite well, and, as a result, Chinese companies are also working hard to establish their own brands.

There are also increasing activities that seek to protect consumers’ rights. Several years ago, Toshiba notebook computers and Mitsubishi Motor’s products were severely criticized in connection with quality problems. While some commented that such criticism “was targeted at Japan,” in reality China had many lawsuits filed against foreign manufacturers in connection with after-sales service including German automaker Mercedes Benz. Many more complaints were filed against domestic firms relating to product quality. In response to such claims, Chinese automakers have introduced a recall system and continue to make serious efforts to properly address national consumers.

The growth of the middle class is also observable in the emerging nationalism. In the Asian Cup football games that commenced in the latter half of July 2004, the Japan team was bitterly booed by Chinese football supporters. The booing was analyzed and determined to have “derived from anti-Japanese sentiment at the national level, generated by anti-Japan education performed in the era of Jiang Zemin.” In reality, however, the booing was part of the nationalism that emerged in the late 1990s along with the economic growth (similar to Japan’s anti-Japan-U.S. Security Treaty movement and campus riots that took place around the days of the Tokyo Olympics, and to Korea’s anti-dictatorship and anti-U.S. movements around the period of the Seoul Olympics). The rising nationalism was initially targeted at the United States. When the Chinese Embassy in Yugoslavia was hit by a U.S. missile in 1999, citizens and students by the hundreds of thousands staged an anti-American demonstration, and threw stones at U.S. diplomatic facilities. In Chengdu, demonstrators burst into the U.S. Consulate General. In and after 2001, however, the 9/11 terrorist attacks in the U.S. led to strategic cooperation between the U.S. and China, while, on the contrary, China’s nationalism is now vigorously targeted at Japan because of Prime Minister Koizumi’s annual visit to Yasukuni Shrine, which is dedicated to the war dead including Class-A war criminals. An important thing for a Japanese firm to properly understand is that this kind of nationalism may adversely affect both countries’ economy and corporate activities, and for such firm to act in a cautious and prudent manner.

Now, how should a Japanese firm deal with the Chinese market that is expanding to an

unprecedented size in line with the growth of the middle class? Chinese markets and Chinese consumers' behaviors or sentiment may not be as mature as in advanced nations; however, if the firm deals with Chinese markets and consumers following its customer creed, which is naturally required of a business firm, it will surely be able to comprehend what the Chinese markets and consumers are like.

The new leadership's intention to shore up revenue growth has now shifted to rural and inland areas, while the middle class continues expanding. Such circumstances are likely to provide Japanese firms with many business opportunities. For instance, educational, cultural or welfare facilities, which are almost nonexistent in rural areas, will likely be built at a fast pace in the future. Educational and leisure industries in urban and coastal areas will inevitably develop.

It will not necessarily be negative for a Japanese firm if the middle class begins to look relentlessly at product quality and the related after-sales service. Japanese firms are good exactly at the development and supply of high-value added products. They have prior experience and expertise accumulated over several decades in responding to the needs of very selective and demanding customers. The future growth of the Chinese market depends to a considerable extent upon the consumption growth of the middle class. It will be the top priority for a Japanese firm to deal with this portion of such wealthy people, and especially to win the confidence of this middle class by means of good communication. In respect to market creation, a Japanese firm may expect good results if it supplies high-quality products, implements a reliable quality control system in China, or builds an online network covering all regions as well as a market and product information service system, and a databank that enables searching for foreign business and product information.

If you understand that the emergence of China's nationalism is a phenomenon that is likely to present itself at a certain phase of economic development, you need not view the current harsh anti-Japanese sentiment as a fixed, lasting one. You should propose to Japanese politicians and government leaders that politics not obstruct economic exchanges, while at the company level you should act prudently to avoid becoming a target of criticism from the Chinese media, and take countermeasures as quickly as possible should any problem occur.

#### 2.4 Know the risks lying behind the opportunities

For Japanese firms, growing China is not a threat but an opportunity, commented Prime Minister Junichiro Koizumi. In fact, the 2003 recovery of the Japanese economy was partly driven by the growth of exports, which is more than 70% attributable to China.

On the other hand, however, you should never forget that the Chinese market is where risks and opportunities always coexist. Why so? In the first place, China is not an advanced nation equipped with a mature market mechanism. It is still a developing country in all respects. Its vigorous growth

offers many opportunities, but problems as well. Let me give you an example. An advanced nation is generally a law-governed nation. To be governed by law, a nation requires a set of elements composed not only of a complete system of laws, but also of powerful law enforcement organizations (police, prosecution, courts, taxation office, etc.), and the general public's law-abiding consciousness. China has implemented laws and regulations to a more or less acceptable degree, but is still behind in having law-abiding law enforcement agencies and people. Today's reality is therefore that "the law is there, but nobody obeys it" or "the judgment is given, but never executed."

In the second place, China is in a period of transition in all respects. The worsening corruption of public officials is attributable to many different causes. For one thing, it has also been pointed out that the harsh discipline practiced in the days of Mao does not exist any more, and the nation still lives in an intermediate phase not yet reaching a "law-governed nation." The implemented "Administrative permission law" or other means has begun to limit the administration's intervention in economic activities. We should say, however, that at the present stage the one-party regime still largely permits political powers to intervene in economic activities, thereby giving rise to corruption.

From a macro standpoint, what kinds of risks will a Japanese firm confront when entering the Chinese market? Chinese scientists point out the following "six basic challenges"<sup>16</sup>: (i) pressure exerted by the successive arrival of three peaks in respect to the population (total population, employed population, and elderly population); (ii) constraints imposed by energy and other natural resources; (iii) ecological deterioration; (iv) pressure created by the rural population shifting to urban areas; (v) difficult correction of intra-regional gaps and 3As-problem (agricultural land, agricultural villages, and agricultural people); and (vi) fostering of capabilities to sustain development and compete in international markets.

The writer as well fears that a bottleneck in aspects directly related to economic activities will likely be caused particularly by the shortage of energy and other resources, and environmental destruction and pollution problems (and the spread of AIDS, Minamata Disease and the like deriving from such problems). In respect to political and social fronts dealt with in this chapter, the writer is worried that the corruption problem and antagonism between people may become destabilizing factors over the next few years.

A glimpse of the problem of corruption practiced at governmental and other public offices by public officers was seen through the accounting report presented by Lin Jin Hua, director of the General Accounting Office of the State Council, at the 10th meeting of the Standing Committee of the National People's Congress held in June 2004. The report enumerated five serious problems<sup>17</sup>: (i) infringement on state property and diversion of public funds such as relief funds, education

funds, Olympic funds and public bonds (corruption was also detected in the central government's ministries and agencies); (ii) defective supervisory system of financial institutions, which has permitted many cases of misconduct to be committed through collusion between elements inside and outside the institutions, and huge amounts of illicit loans and insider trades; (iii) widespread tax evasion and inadequate functioning of taxation divisions, some of them giving a helping hand to illicit acts; (iv) disorderly designation of development zones by means of which local governments illegally purchase or sell land; and (v) private enterprises swindling state-owned banks out of loans. The disclosure of these problems by the organization in charge was intended to show how determined the new leadership is in addressing them as well as how serious the problems are.

Another social problem is the antagonism that has surfaced at the popular level. The development-priority policy pursued thus far is now being paid for. The general public that had so far no time or money to protect their rights now files lawsuits against local governments or public officers, or brings cases directly to Beijing, and if their complaints are ignored, at times resort to mass protests, determined to collide against local governments or the police if necessary. At the end of October 2004, in Huan Yuan Prefecture, Sichuan Province, more than 50,000 farmers were ordered to evacuate their villages because of the hydraulic power plant construction. In an act of repulsion, the farmers staged a protest besieging the local government office and clashed against the police with some of them dying. After the incident, President Hu Jintao issued 4-item instructions (corrupt officials shall be severely punished, farmers shall not be held responsible, etc.), and dismissed the secretary of the prefectural party committee, settling the situation for the moment. In the following month of November, similar protests were conducted in Yan Shan Prefecture, Yunnan Province and Jie, Guangdong Province. Under the present circumstances where there exists no proper channel that enables the central government to absorb or dissipate the rising frustration of the general public, some areas may see serious social incidents or the unpreventable deterioration of security.

To avoid risks in the Chinese market, a business firm will be required to make efforts - should any trouble occur - to deal with it while always accompanied by counsel and maintaining a record of all things discussed and agreed upon; properly understand local policies as well as certain different interpretations of applicable laws and regulations, and then address each of the different and diverse problems; give importance to regular exchanges and communications with employees, local residents and public offices; and further, make adequate contributions to society to enhance the firm's image in Chinese society.

### 3. Chinese market in 2010 and 2015, and political and social changes: 3 scenarios

So what will the Chinese market be like in 2010 and 2015, as affected by political and social

changes then occurring? There will likely be the following three scenarios if the market is forecasted along the closed-open axis, the dictatorial-democratic axis, or the destabilized-stabilized axis, each of which will affect the way politics and society will be.

### 3.1 Standard scenario (probability 70%): Growing middle class will expand the market

Market size will expand in line with the growing middle class. Market management under WTO rules will enable foreign-owned and locally-owned firms to compete within fair conditions.
The communist party regime will remain basically unchanged; however, there is some possibility that direct elections will be adopted toward 2015 on a trial basis in some smaller cities.
The administration's interference in the management of private firms will gradually cease to exist, and private firms' owners and management will positively speak up on economic policies. Protectionism may be retained by local governments.

The middle class including those self-acknowledged people will expand to such an extent that there will rise growing calls among them for the liberalization of economic activities, which will prompt deregulation in many areas. The government's interference in the management of private firms will gradually cease to exist, while private firms' owners and executives will begin to impose requirements regarding economic policies by joining the communist party.

Markets will be managed entirely under WTO rules, enabling foreign-owned firms to compete with local firms within fair conditions under improved business environments.

The new leadership will impose severe punishment on bureaucrats involved in corruption within the party and the government. It is unlikely, however, that the government will seek to address such complaints and criticism or widening income gaps by immediately proceeding to democratization through a direct election at the national level.

What continues to govern the nation will be the communist party. As of now, no political party has grown big enough to succeed to power. A national election will still be decades away, while an election in rural areas will not be an immediate possibility because the low education level will be an obstacle.

The communist party will address democratization very carefully, while taking in private firms' owners and executives. The party experienced direct investment being halted for some time by foreign capital when the 1989 Tianamen Square incident disgusted them. The party will, therefore, nip in the bud any movement in local areas of protest against corruption, and take all possible measures to avoid such movement from spreading into confusion or turmoil in big cities like

Beijing and Shanghai.

Political turmoil will not be preferable to the middle class as well for the reason of economic interests because it will lead to reduced foreign investment. Thus, although the middle class may move to impose some requirements on corporate behaviors by exercising consumers' rights, they will not go as far as to loudly call for the party and the government to implement democracy by means of a direct election.

The present political regime will likely be basically maintained until around 2010, when the Beijing Olympics and the Shanghai Expo will be over.

Over the ensuing years to 2015, a few direct elections may be held in some rural areas or smaller cities on a trial basis, but the basic political structure of the communist party rule will remain unchanged.

Market players will be the growing middle class, who will contribute more or less to the healthy expansion of consumption. In terms of the quality of the market, however, protectionism will largely be retained by local governments and totally transparent markets will not be realized despite superficially advancing deregulation under WTO rules, because the interests of vested interest groups, still existing among the party and government officials, cannot be completely ignored or neglected.

Foreign-owned firms may expect markets to grow, but should understand that deregulation and transparency will progress slowly and gradually.

### 3.2 Optimistic scenario (probability 20%): law application will become transparent and market quality will improve

The middle class will steadily grow into the core market players. On the political front, in 2010, heads of provinces and municipalities as well as assembly members thereof will be elected through direct elections, and in 2015 direct elections will be held at the national level.
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The legal system will be upgraded, laws and regulations will be enforced in a more transparent manner, and market quality will improve. Intellectual property rights will be protected. The middle class, embracing diverse values, will become the core consumers. Competition among companies will become more transparent and fierce in line with the growing market.
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Preconditions for the above possibility to become a reality are: the leadership members will maintain properly balanced economic growth and social stability, and guide political matters in a more or less appropriate manner taking in public opinions; and China will be favored by a relatively stable international environment (no U.S.-China confrontation and no war in the Taiwan

Strait) and by favorable natural environments (no large-scale natural disaster). In the days of Chiang Ching-kuo, Taiwan had the middle class steadily grow, recognized opposition parties, and proceeded with gradual democratization under the rule of Lee Teng Hui. The gradual democratization process may be termed the “Taiwan model.”

As of 2010, China’s middle class comprising of middle income groups and the self-acknowledged middle class will account for over 60% of the total population, of whom the middle class really supported by the corresponding income and living standards will be more than 400 million. Political democratization will gradually advance, and in economically advanced coastal areas, heads of provinces and municipalities as well as assembly members (people’s representatives) will be elected through direct elections. During the 2015-2020 period, China may see elementary democracy implemented as national-level direct elections will be held and the political regime will shift to a multiparty regime. China is so vast that intra-regional disparities and the gradualness of political and social reform being promoted will likely give rise to local, temporary confusion and provoke political debate among the top leadership members. Such possible situations, however, will not run counter to the general “mega trend.”

Under this scenario, the Chinese market will move on along or close to the track followed by Taiwan, Korea or other Asian NIES countries, gradually forming a mature market. For its part, China has set its reform goal of building the basic framework of a “socialist market economy” by 2010 and establishing a sound market mechanism by 2020. At such time, the Chinese market will be simultaneously equipped with full transparency, fairness and a huge capacity, and will attract the whole world.

The size of the market will substantially widen due to the growing middle class. Not only will China’s purchasing power rise, but also the consumer base will become wider under diverse values, which will give both volume and depth to the market where different products of the same type will sell in diverse price ranges and features. A market survey-oriented firm may develop products that anticipate the future fashion and take the lead over competitors. Firms will be required to take in the lifestyle of the middle class.

In terms of market quality, the legal system will be upgraded further and its management will become more transparent, and, thereby, fair competition will be secured. Local governments will cease to interfere in corporate management, and foreign-owned firms and Chinese firms will be placed in the same indiscriminating, competitive environment under WTO rules. Companies will become more compliance-conscious. Intellectual property rights will be more extensively protected and copycat products will be strictly controlled. Foreign-owned firms will have greater business opportunities in a more transparent competitive environment due to less complicated management. The expanding market size, however, will lead to fierce disorderly competition involving Chinese

and foreign-owned firms indiscriminately, while consumers' preferences and fashion will rapidly change. All companies will be required to work harder to develop and introduce salable products into the marketplace.

The expanding middle class will become increasingly conscious of product safety and environmental protection, making it a requisite to incorporate safety and environment-protective features into all products as well as to provide attentive and meticulous after-sales service.

This is the most desirable scenario for foreign-owned firms including Japanese companies. In view of such possibility, all Japanese-owned firms should make efforts to enhance their image and the strength of their brand in the Chinese market, and to become an element that assimilates into Chinese society. Even under this scenario, Japanese firms should not expect to be free from all problems. Specifically, changes being brought about by rising labor costs, gaps corrected to a certain degree and the full-scale emergence of middle-income groups appear to require Japanese firms to adapt their strategies toward a management style more closely related to Chinese society.

### 3.3 Pessimistic scenario (probability 10%): political turmoil will lead to temporary confusion of the market

Appearance of political leaders eager to implement top-down democratization will lead to the declaration of democratization before the middle class has grown into adequate market players. Markets may be placed in temporary confusion, while the end of interference by governments will facilitate the management of foreign-owned firms.
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This scenario, however, may lead to enhanced right consciousness and give rise to frequent labor disputes. Improvement of the legal system and application of appropriate laws may not spread to a sufficient extent and depth for lack of time, which may not help the markets to become very transparent.
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At the present moment, this scenario seems unlikely. It should be kept in mind to a certain extent, however, that this scenario may become a reality in a dramatic manner, if sporadically occurring confrontations between farmers and urban dwellers for one part, and governments and public officials for the other, further intensify, or if a Gorbachev or a Zhao Ziyang comes to power seeking a frontal breakthrough to all political and social problems by means of democratization. In 1986, Korean President Roh Tae Woo all of a sudden declared democratization as he was confronted with nationwide protest rallies. The failed 1989 Beijing pro-democracy movement was at one time inspired by a similar expectation. This scenario assumes a shift to democratization by a political leader's guidance as was the case with Korea.

China is unlikely to carry out early democratization, as things go on developing naturally. The continuing economic growth has been preventing the citizens' power from coming together to reform the present political system, and the communist party made up of elites still retains the power to control the entire society. The middle class that serves as a true foundation for democratization has not yet grown into society's mainstream. History, however, does not necessarily start moving when every condition has been fulfilled. The Korean case does not entirely deny us the possibility that a leader like Roh Tae Woo or Gorbachev may appear amid popular protest rallies, spreading country-wide on the back of the growing middle class and changing external environments. Internal conditions for such a possibility to be realized are supposed as: frustrations among farmers and urban citizens become horizontally connected with each other and grow into nationwide political movements; public opinion is divided over how certain problems or incidents have been dealt with and causes the leadership to plunge into an internal heated debate beyond control, which turns into the focus of attention inside and outside of the country; and externally, the world's major powers become united and collaborate to work with internal movements within China and exert pressure on the Chinese government. In circumstances where these conditions occur concurrently, a leader like Korean President Roh Tae Woo will appear and declare democratization against all opposition within the leadership in an attempt to resolve the situation due to internal and external pressure. This is the possibility contemplated in this scenario.

When things move toward this scenario, however, the Chinese market will probably not be free from weaknesses that accompany a premature market, or continue to be immature and ridden with problems. In a social atmosphere where politics prevails over other issues, improvement of the market mechanism is likely to be given lower priority. Foreign-owned firms will have easier entry into the Chinese market given fewer political barriers (governmental interference and the like), however, at substantially greater risks. For one thing, their management will be required to make a crucial decision as to whether or not their Chinese business will be profitable amid intensifying labor-management disputes and calls for employees' and employers' rights. Furthermore, there will be an increasing possibility that the government's weaker control over its market and monetary policies may not prevent speculative funds from stampeding into or out of the Chinese market, triggering a currency crisis as represented by the 1997 Thai and Korean crisis.

Different than under the optimistic scenario, the Chinese market contemplated in this scenario is likely to see democratization declared before the middle class has grown to an adequate size. Then, the democratizing mood will start running ahead before core consumers have been established and cause a temporary consumer spending spree; however, such spree may instantly turn into a careful and cautious mood once people feel inclined to see what "democratization" represents and will be like in the future. All this is likely to make the market fluctuate. It is also likely that various

restrictions and controls imposed on firms will be lifted before any proper method of macro control is established, and, as a result, the management environment is placed in temporary turmoil.

In respect to market quality, democratization declared preceding the necessary progress of low-profile work, such as providing greater transparency to the legal system and to the application of laws and regulations, may cause people to feel that the market as well will become more transparent; however, the government may not be able to fully protect intellectual property rights or otherwise protect the market once any labor-management dispute becomes complicated and requires the government's intervention. While generally, the government's supervising "eye" is apt to fail in reaching the overall market, some of the firms may engage in the production of copycat products or otherwise deviate from fair competition, creating a confusing situation for foreign-owned firms.

To be prepared for this scenario, all foreign-owned firms including Japanese companies should dispassionately recognize the possibility that the rules that justify human rights and freedom will be ignored and the checking/supervising system will temporarily recede, and place great importance on economic risks that are likely to be produced in a period of political excitement. A foreign-owned firm should at least temporarily hold back additional investment and business expansion, properly assess the situation, and observe that political or social swings affect corporate activities to a minimum degree. Also in view of the reality that Chinese nationalism is often targeted at Japanese firms, all Japanese firms should watch that such nationalism, once freed from political weight, is not intensively focused on Japanese firms, and watch further that should any trouble occur, it is quickly resolved and the truth is disclosed, and thus avoid any unfavorable atmosphere from building up and criticism from spreading against all Japanese firms. On the other hand, Japanese firms should draw up a medium- to long-term strategy aimed at creating an image of "Japan contributing to China's democratization and modernization" with the participation of the Japanese government to be ready for future structural changes due to occur in Chinese politics and society.

Another possibility is that the continuing domestic turmoil will turn into a movement calling for political democracy; it may happen, however, that the movement is suppressed coercively by the governmental authorities, or that political powers break up while the party leadership loses its centripetal force. Such situation will result in a kind of chaos, and the economy and society will be thrown into greater confusion. A good example is represented by Russia: for some ten years following the dismantling of the Soviet Union that took place at the end of 1991, Russia continued in confusion while its GDP remained at half of what it used to be.

Should such a situation occur, it is inevitable that China's value as a market will considerably decline. Not only will the market size shrink substantially but also the government's function will

come close to a state of paralysis; then, those who are responsible for the institution and protection of rules will disappear, the market will cease to be equal, fair or transparent, inequality will widen, the underground economy will prosper, and national or corporate assets will massively flow out of the country. In such a case, the government may be forced to place the economy under temporary control. In the period of transition from the planned economy to a market economy that started at the end of the 1980s, bureaucrat brokers were very active behind the scenes; they misused the privileges granted to the party and government officials, and made huge profits by diverting to illegal channels production materials (coal, etc.) and consumer goods, while consumers on their part ran about in massive panic buying in anticipation of a general price hike that would precede the elimination of price controls.

At the present moment, consumer behavior similar to any panic buying is unlikely in an oversupply economy totally different from the short-supply economy of that time; however, a nonfunctioning government in charge of establishing and controlling market rules will cause the market order to plunge into great confusion.

In respect to market quality, transparency will immediately be lost from the market, and consumers will feel increasingly uncertain about the future and curb their spending. This will lead to a sharp market contraction.

Foreign-owned firms will be able to do almost nothing to save China from falling into a collapsing spiral. Should such a situation occur, the safest thing for a Japanese firm to do would be to temporarily downsize its business or withdraw. If the firm wants to take the remaining slim chance that is provided by the market, it should limit its business activities to in and around a few cities in coastal areas (Shanghai, Dalian, etc.) and seek protection from national-level or local-level political leaders and strengthen its personal connections in an increasingly “man-ruled” nation.

### 3.4 Grasp the mega trend prevalent in Chinese society: seven recommendations to Japanese firms

The writer believes that even under the above pessimistic circumstances there will be a 70% possibility that Japanese firms will steadily go on moving forward through a trial and error process. If a questionnaire survey is conducted in China, probably a similar percentage of the respondents will reply to the similar effect. If such is the policy followed by Japanese firms for China, then they should draw up a strategy and policies under the 70%-probability standard scenario. Over the last 20 years, Japan has undergone many violent fluctuations in its perception and judgment of the Chinese market and its environment. Three times - in the early 1980s, during several years following 1992, and after 2003 - Japan has seen a “China Boom” surge; however, in a rushing race toward China, no Japanese firm was so level-headed as to take measures based on a dispassionate

assessment of existing or potential problems and China's particularity, and ended up in not just a few failures. On the other hand, in other periods, Japanese firms were so pessimistic about the Chinese economy and market that until a few years ago Japanese mass media preferred to see in China only political and social instability, or an underdeveloped economy and market, even noisily talking of "people cheating people" or "massive capital flight," and created an impression that China might collapse at anytime. As a result, many Japanese firms missed the best timing for entering the Chinese market.

Trends in China to 2015 reveal that China will continue to be in a period of overall transition where advancing computerization and rising right-consciousness of Chinese people may cause problems and frictions to become more apparent. NIES nations like South Korea and Taiwan also have come through such period. Will such a situation be a condition so serious as to prevent Japanese firms from going into the Chinese market? The writer does not believe so for the following four reasons.

(1) Surely there is an increasing number of people who are not satisfied and voice criticism or resort to protest movements, but the majority of Chinese people do not want a confused economy or society, and, therefore, frictions take place in circumstances that are not likely to affect the stability of society at large—this way of looking at China seems to be necessary. Although Chinese society will not be free from sporadic incidents or frictions occurring in the future in some regions, such incident or friction is unlikely to develop into great confusion spreading across different regions or into organized antiestablishment movements; and particularly so in the coming years, because the 2008 Beijing Olympics and the Shanghai Expo 2010 will serve as a booster shot. The new leadership is working to shore up the economy of notably problematic rural areas. The majority of the Chinese people will not opt for any extreme if they see "hope for the future."

(2) The politics-people relationship in China is changing from the traditional unilaterally forced relationship to an interactive, mutually-actuating relationship. A mechanism is in place that "absorbs" public opinions while institutionalization and legislation relating to politics, society and the economy are moving ahead. All this represents the improving process where solutions are given to more than ten centuries-old problems that are surfacing today. We may expect some positive results from this ongoing process. Should the Communist Party of China resort to the traditional, outdated and single-minded policy of "suppression by force," it may put down protest movements to the apparent stability of society, but such suppression will permit "explosion-oriented magma" to accumulate.

(3) Indeed nationalism is emerging in China; however, it is not equal to "anti-Japan sentiment," as I have said earlier. Japan should prudently deal with the problems targeted by Chinese nationalism, particularly political leaders' visit to Yasukuni Shrine, and see that such problems do

not obstruct economic exchanges between the two nations. For their part, the new Chinese leadership stated their policy of laying emphasis on its relationship with Japan, and regretted what had happened in the Asian Cup football games. Immediately after the incident, the popular magazine *Newspaper Weekly* sounded the alarm in its editorial saying, “We should be careful lest the malignant nationalism that dominated Germany and Japan one century ago reappears in China and emotionally drags us into losing reasonable judgment.” In the future, Chinese nationalism is likely to be targeted at the Taiwan issue and the United States standing behind it. For our part, Japanese firms should hold dialogs with China’s mainstream society and the middle class, and seek to improve their image.

(4) When considering China’s different problems, we should not apply our own measuring rule, overly eager to find fault with the Chinese way of doing things; rather, we should interpret them just as a process of a phenomenon often seen in developing countries. We should go over all the efforts made by Japanese firms in the process of entering the U.S. or Southeast Asian markets between the 1960s and 1980s, and deliberate on a long-term strategy aiming for long-lasting coexistence with the Chinese market and membership in Chinese society.

So then, how should a Japanese firm seize opportunities and avoid risks based on the assumed future of Chinese politics and society? I would like to make the following seven recommendations.

(1) Accurately grasp and establish a long-term strategy based upon mainstream developments and changes where the reform and open market policy is not only irreversible but also bound to proceed toward democratization that will gradually and increasingly absorb middle class-dominated society and public opinions; and mentally prepare for any sudden changes at the same time.

(2) Give greater importance not only to developments within the central government but also to changes occurring in local areas and societies. Actually, China tends to be divided into six economic zones and social activities zones (South China including Guangdong, East China including Shanghai, Bo Hai including Beijing and Tianjin, three provinces of North East, Central China, and inland regions). It is necessary, therefore, to address each zone differently, and successfully seize business opportunities arising out of intra-regional differences and different development stages.

(3) Build a conduit to China’s “new new leaders” or the fifth and sixth generation elites. Hu Jintao, Wen Jiabao and other leaders were students before the Great Cultural Revolution and are called in China “the fourth generation.” As they came through the Cultural Revolution, this tier has a rather narrow base. On the contrary, “the fifth generation,” which is made up of a generation of students who were in university during the first few years of the Cultural Revolution (especially those who were in university between 1977 and 1979), are now working in full scale at the forefront of the central and local governments or economic leadership. Also “the sixth generation”

up to their early forties is steadily increasing their prominence. A relationship with these generations will prove to be of decisive weight in building personal connections and a relationship of mutual trust in China five years hence.

(4) Place emphasis on dealing with the mass media based upon the proper comprehension of how print media and the Internet peacefully coexist in China. Have proactive exchanges with opinion leaders of China's different societies and communities and seek to correct any misunderstanding on the Chinese side through their conduit while also promoting communications with them.

(5) Avoid viewing troubles involving Japanese products and merchandise just as a product of "anti-Japan sentiment." Give greater importance to the feelings or psychology of Chinese society and of the people reflected therein. Address such troubles in a faithful manner.

(6) The growth of the market and changes in consumers' tastes and sentiment present common characteristics consistent with each stage of development. Study what similarity is observed between China's different stages of development and the general currents of changes that occurred in the "period of social transition" in Japan, South Korea and Taiwan. Forecast the needs of Chinese society, market and consumers based on the commonality and linkage found in the characteristics that featured the transition in the three countries and in those featuring the transition currently occurring or due to occur in China; and then, proactively deliberate on measures to take.

(7) All firms should not merely address markets and products. Observe social changes more closely, accurately grasp the way of thinking, wishes and dissatisfaction of local people, seek to deepen dialogues with them and enhance the corporate image, make contributions to and become a member of the local community.

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<sup>1</sup> Shu Ken Ei, "Three representative theory and socialism," *China Yearbook 2002*, compiled by the Institute of Chinese Affairs, p. 74.

<sup>2</sup> Cai Fang and Lin Yifu, *Chinese Economy*, China Finance and Economy Editorial, 2003, pp. 244-246.

<sup>3</sup> *Telecommunication Review*, Beijing, December 11, 2004.

<sup>4</sup> *People's Daily*, November 17, 2004.

<sup>5</sup> *Outlook Weekly*, No. 11, 2004.

<sup>6</sup> *Xinhua Monthly*, No. 4, 2004, p. 9.

<sup>7</sup> "Law-governed administration: ten-year goals of the government," Xinhua News Agency, April 20, 2004.

<sup>8</sup> Morning edition of *Asahi Shimbun*, December 11, 2004.

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- <sup>9</sup> *People's Daily*, March 1, 2004.
- <sup>10</sup> Xinhua News Agency website "Xinhua Net," March 8, 2004.
- <sup>11</sup> According to a tentative calculation made in a report prepared by a U.S. company, China's super-rich class worth \$1.0 million or more are represented by 236,000 people as of the end of 2003, whose combined assets amount to \$969.0 billion. *The 21st Century Economic Report*, Beijing, September 12, 2004.
- <sup>12</sup> *People's Daily*, August 14, 2004.
- <sup>13</sup> Based on the report presented by Prime Minister Wen Jiabao at the 2nd meeting of 10th-term National People's Congress, *People's Daily*, March 17, 2004.
- <sup>14</sup> *Ta Kung Pao*, Hong Kong, November 16, 2004.
- <sup>15</sup> Based on an article in the *China Youth Daily*, March 29, 2004.
- <sup>16</sup> "China's six fundamental challenges for development in the 21st century," Xinhua News Agency, May 14, 2004.
- <sup>17</sup> *Financial Review*, Beijing, July 13, 2004.