

## Chapter 8

### *Olympic Parallels with Japan and South Korea*

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#### **Key Points**

- Japan and South Korea, the previous Asian hosts of the Summer Olympics, achieved rapid economic growth thanks mainly to burgeoning exports driven by their development of heavy and chemical industries and trade liberalization. China is in a similar situation as it prepares to host the Beijing Olympics.
- China lags behind, however, in terms of putting in place the infrastructure of social stability, such as alleviating income disparities and establishing social security systems—tasks that Japan and South Korea had either completed or were close to completing when they staged the Olympic Games. In addition, while Japan faced such challenges as energy saving and environmental problems after it hosted the Olympics, China is having to address these issues at the same time as it prepares for the Games.
- Looking at the post-Olympic prospects for the Chinese economy through to about 2015, while there are bound to be fluctuations, there is a high probability that growth will remain solid. To avoid major confusion should growth decelerate for some reason, it is important for Japan to cooperate with China in such areas as the establishment of a social security system.

#### **Key Data: China's Fragile Social Foundations Compared to Japan and South Korea When They Hosted the Olympics**

Per capita GDP	China (2006) \$1,998	Japan (fiscal 1964) \$3,051	South Korea (1988) \$4,465
Gini coefficient	China (2004) 0.47	Japan (1962) 0.39	South Korea (1988) 0.30
Unemployment rate	China (2006) 4.1% (rate of urban registered unemployed)	Japan (1964) 1.1%	South Korea (1988) 2.5%
GDP export ratio	China (2006) 36.9%	Japan (1964) 22.5%	South Korea (1988) 32.3%
Cars per household	China (2006) 0.04	Japan (1964) 0.07	South Korea (1988) 0.1

Source: Compiled by the author from various materials

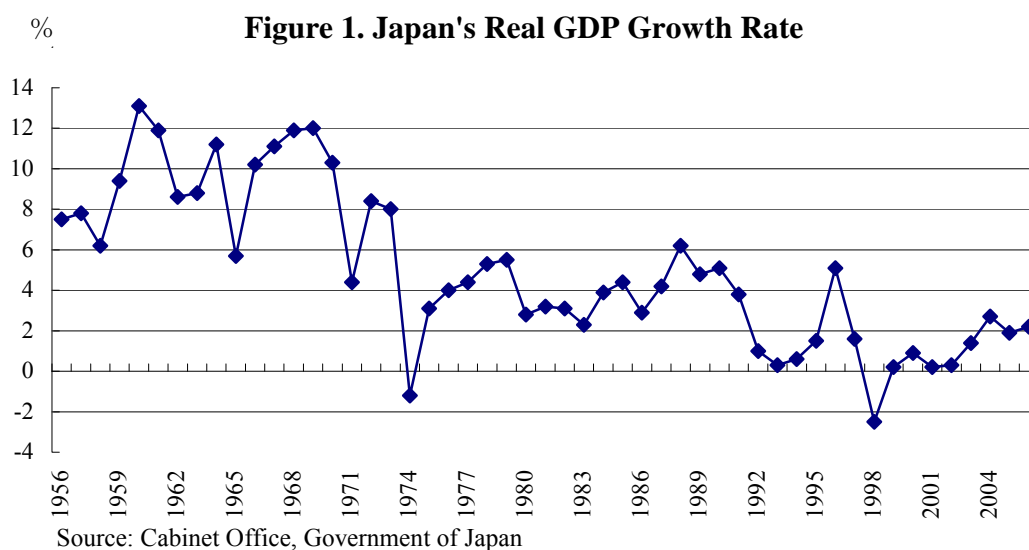
### 1. Tokyo Olympics Marked the Peak of the High-Growth Era

The 1964 Tokyo Olympics were held at a time when Japan had left behind the era of postwar reconstruction and entered the era of rapid economic growth. The Japanese economy sustained annual growth of around 10% throughout the 1960s (figure 1). Japan at this time was developing heavy and chemical industries and was expanding its exports by liberalizing its trade with other nations while improving its industrial competitiveness. The industrial sector actively invested in plant and equipment, fueling a technological revolution. As people migrated from rural to urban areas and agricultural productivity improved, income disparities narrowed and Japan essentially achieved full employment. This was also the period when Japan put in place social security systems, including pensions and health care.

Japan's hosting of the Olympic Games accelerated the construction of infrastructure and transportation networks, especially in and around the capital, Tokyo. A plan to double incomes, which symbolized the high-growth era, was achieved ahead of time, and rising incomes sparked a post-Olympic consumption boom in the 1960s, centering on the "three Cs" of a color television, a cooler (air conditioner), and a car.

Meanwhile, as the improved competitiveness of Japanese exports produced year after year of trade surpluses, there was growing international pressure on Japan to liberalize its economy, and in the late 1960s the country implemented a gradual capital liberalization.

The increasing concentration of the populace in cities led to traffic jams, skyrocketing house and land prices, and other problems, while the shift to heavy and chemical industries gave rise to pollution-related problems. Japan was becoming robust enough, however, to overcome these challenges and to withstand the two oil crises of the 1970s and the impact of currency fluctuations.



## ***2. Growth Sustained by Heavy Industry and Free Trade***

The foundations for Japan's rapid growth in the 1960s were laid through the development of heavy and chemical industries. All over Japan steel manufacturers, petrochemical firms, and other materials industry players constructed and began production at huge steelworks, industrial complexes, and other plants fitted with the latest equipment. The materials industry's growing production base in turn enabled the automobile, electronics, and electrical industries to step up production and make their exports more competitive.

The steel industry improved cost competitiveness and quality by constructing larger blast furnaces, introducing continuous casting equipment, and using computers to rationalize production management. This period saw production begin at numerous core steel plants, including Nippon Steel's Kimitsu and Sakai plants (the former of which, then operated by Yahata Steel, was visited by Chinese leader Deng Xiaoping), Sumitomo Metal Industries' Wakayama plant, NKK Corporation's (now JFE Engineering Corporation) Fukuyama plant, then Kawasaki Steel's Mizushima plant, and Kobe Steel's Kakogawa plant.

In the petrochemical industry, Tonen, Maruzen, Idemitsu, Daikyowa, and other manufacturers built industrial complexes in locations including Kawasaki, Yokkaichi, Chiba, Mizushima, and Tokuyama.

Supported by this development of infrastructure in the steel, petrochemical, and other material industries, the car manufacturing industry also accelerated its development in the 1960s. The Japanese automobile industry had established production bases in the late 1950s and early 1960s, such as Toyota's Motomachi Plant and Nissan's Oppama Plant. The development of heavy and chemical industries fueled substantial and sustained growth in car production throughout the 1960s, taking production from 480,000 vehicles in 1960 to 4.09 million in 1968, an increase of 750%. After the Olympics, the trend toward car ownership gained momentum with the advent of popular cars in 1966, and in 1969 passenger cars' share of total motor vehicle production surpassed 50%. Car exports boomed after manufacturers made the passenger car a strategic model in 1965 and the low prices of Japanese cars became a selling point. By 1970 exports of passenger cars stood at double those of commercial vehicles.

The electrical appliance industry grew on the back of the electrification boom in the late 1950s and early 1960s. The boom centered on black-and-white televisions in the late 1950s and refrigerators in the early 1960s. TV broadcasts had begun in 1953. Between 1955 and 1960, sales of the "three holy durables"—washing machines, black-and-white TVs, and refrigerators—increased by factors of 3.5, 26.1, and 29.2, respectively. After the Olympics, color TVs and air conditioners took over as the engines of growth in this sector in the late 1960s. Production of color TVs went into full swing in 1964, but as broadcasts of the Tokyo Olympics were relatively short and color TVs expensive, the event did not spark increased demand. Color TVs overtook black-and-white sets in terms of value of production in 1968, becoming the top-ranked electrical product by this measure, and surpassed black-and-white TVs in terms of

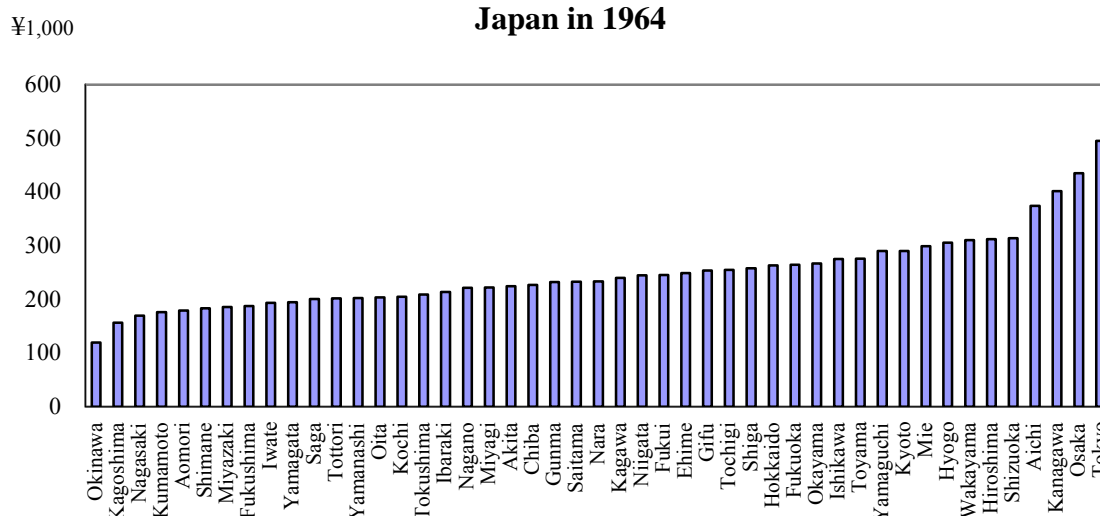
production units in 1970. Production of air conditioners shot up from 140,000 units in 1966 to 760,000 in 1968 and almost 1,000,000 in 1969. While 35,000 black-and-white TVs were exported from Japan in 1960, this figure grew to 984,000 in the Olympic year of 1964 and to 2,761,000 in 1969, when the export ratio of these products rose to 37.9%. The diffusion rate for color TVs jumped from 26.3% in 1970 to 85.9% in 1974, while exports doubled from 1 million units in 1969 to 2 million in the mid-1970s.

Japan liberalized its external trade in the 1960s, after the government issued the General Framework of Liberalization of International Trade and Foreign Exchange in 1960. Japan's trade liberalization rate reached 92% in 1963, the year before the Olympics, and in April 1964 the country cemented its shift to an open economy by becoming an Article 8 member of the International Monetary Fund and joining the Organisation for Economic Co-operation and Development.

### 3. Infrastructure and the Foundations of Social Stability

By the time of the Tokyo Olympics, large numbers of people had migrated from rural to urban areas through collective recruitment and other means, income levels had become more even, and full employment had almost been achieved. In 1964, the year of the Tokyo Olympics, 23% of Japan's labor force were employed in agriculture. The per capita gross regional product of Tokyo, the top-ranking region by this measure, was 4.2 times that of Okinawa, the lowest (figure 2). In the same year, workers in large corporations with 500 employees or more earned 1.45 times more than those in small and medium-sized enterprises with 30 to 99 employees, and the unemployment rate stood at 1.1%.

**Figure 2. Per Capita Gross Regional Product by Prefecture in Japan in 1964**



Source: Cabinet Office, Government of Japan

Japan had also made progress in establishing social security systems. The National Health Insurance Act was enacted in 1938, and by 1960 almost 90% of the population was enrolled in the National Health Insurance system. Universal health care was achieved in 1961.

The 1960s also witnessed rapid progress in infrastructure development. The Tokaido Shinkansen (bullet train), built partly with a loan from the World Bank, opened just before the Tokyo Olympics in October 1964. Cutting the journey time between Tokyo and Osaka from six hours and a half (using the old Kodama express) to three, it enabled people in one city to make business trips to the other and be back the same day. Meanwhile, a nationwide network of highways was also taking shape. The first, 4.5-kilometer stretch of the Metropolitan Expressway opened between Kyobashi and Shibaura in 1962, the Meishin Expressway opened in 1965, and the Tomei Expressway opened in 1969.

The Income Doubling Plan dramatically improved people's standards of living. Announced in December 1960 by the cabinet of Prime Minister Hayato Ikeda, the plan set the objective of greatly improving national living standards and achieving full employment in order to maximize stable economic growth. Specifically, the goals of the plan were (1) to expand social capital, (2) to upgrade the industrial structure, (3) to promote trade and international economic cooperation, (4) to develop human resources and science and technology, and (5) to alleviate the two-tier economic structure (of high-growth and low-growth sectors) and ensure social stability. It aimed to double real incomes over 10 years from fiscal 1961 to 1970 by achieving average annual growth of 7.8%. Many economists at the time expressed caution about the future of the economy, but in fact these targets were achieved in about seven years.

The Tokyo Olympics were held as Japan reached the crest of its high-growth wave, with ordinary citizens feeling the benefits of economic expansion through improved infrastructure, rising incomes, and the increasing availability of consumer durables. This was a time when Japan was opening up and internationalizing. Welcoming so many foreign athletes and tourists for its first Olympics as host nation provided an opportunity for the country to boost its self-confidence within the international community—assisted by the fine performances of Japanese athletes. This rising confidence fueled the consumer boom of the late 1960s.

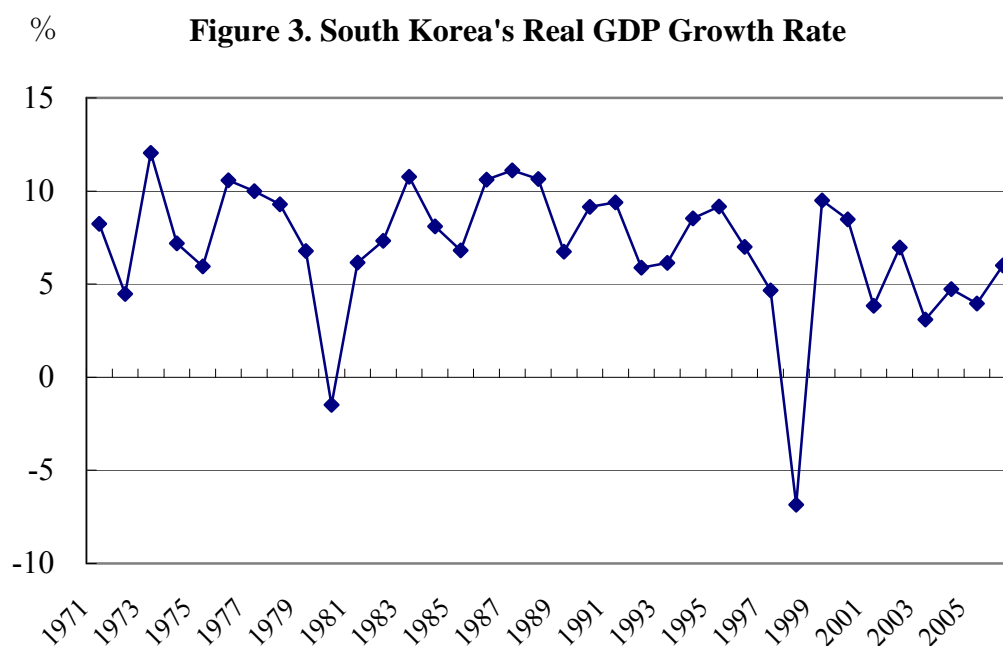
In the year after the Olympics, however, Japan experienced the “1965 recession.” Sun Wave Corporation, Sanyo Special Steel, and Yamaichi Securities were among the big names to go bankrupt, triggering a wave of failures among small and medium-sized businesses and a severe credit crunch. Yet the 1965 downturn had little impact on the size of the Japanese economy, which recovered in a short time. The downturn prompted Japan to switch from a policy of pursuing a balanced budget to an aggressive fiscal approach, including the issuing of government bonds that took the fiscal balance into the red.

Not every consequence of rapid economic growth was positive. The development of heavy and chemical industries brought increased pollution, which caused

such illnesses as Minamata disease, itai-itai disease, and Yokkaichi asthma. The late 1960s witnessed a succession of court cases in which victims of such diseases sued the polluting companies that had caused the pollution for compensation. The passage of laws placing severe restrictions on air and water pollution and stipulating the compensation by polluting companies for residents prompted corporations to improve their environmental practices.

#### 4. South Korea: From Developmental Dictatorship to Democracy

Although South Korea, which in 1988 became the second Asian country after Japan to host the Summer Olympics, also achieved rapid economic growth, unlike Japan this growth occurred under a developmental dictatorship headed by Park Chung-hee, who seized power in a 1961 military coup d'état. As in Japan, the development of heavy and chemical industries was the driving force of South Korea's growth. The assassination of President Park in October 1979 brought an end to the authoritarian regime, however, and the country gradually switched to a democratic system.



Source: Bank of Korea

South Korean industry was already in the grip of a technological revolution before the country hosted the Olympics. Between 1986 and 1988 South Korea took advantage of the “three lows”—a weak dollar, low international interest rates, and low oil prices—to achieve high economic growth, price stability, and a balance of payments surplus. GDP expanded by around 10% a year from the mid-1980s to the early 1990s (figure 3).

South Korea's progress in modernizing its industry was symbolized by Hyundai's success in exporting the Pony to North America, the South Korean

semiconductor industry's feat of catching up with those in developed countries, and steelmaker POSCO's massive investment program. The country also liberalized its import regime, such as by abolishing restrictions on car imports.

It was around the time of the Seoul Olympics that South Korea's social security framework finally took shape with the establishment of a national pension and a minimum wage system. Democratization energized the country's labor unions, and this coupled with economic growth spurred big wage increases; rising incomes in turn lifted the college matriculation rate, causing a personnel shortage. Rapidly rising wages and labor disputes dented South Korea's international competitiveness, while the progress and market liberalization of developing countries intensified corporate competition. Rising incomes, meanwhile, caused property prices to skyrocket and domestic demand to overheat.

### ***5. Korea's Electronics Industry Catches Up with Japan's***

POSCO, a leading symbol of South Korea's development of heavy industry, constructed the Gwangyang Steelworks between 1987 and 1992, creating one of the largest steel plants in the world with an annual production capacity of 11.82 million tons. By 1992, POSCO boasted the sixth largest steel production capacity in the world. Heavy and chemical industries accounted for almost 50% of South Korean exports in 1987, the year before the Seoul Olympics.

In the automobile industry, Hyundai Motor succeeded in breaking into the Canadian market with its Pony Excel passenger car in 1985 and established a new record for foreign car sales in the United States the following year. From 1986 to 1988, South Korean carmakers exported more vehicles than they sold in the domestic market. After the Olympics, however, in 1989 exports to the United States slumped while domestic demand expanded rapidly. Exports dropped from 560,000 vehicles in 1988 to 350,000 in 1989 and had only recovered to 420,000 in 1992, while domestic demand more than doubled from 320,000 in 1988 to 830,000 in 1992. South Korea lifted its restrictions on car imports in its Olympic year, 1988, and reduced import tariffs to 25% the following year.

In the electronics industry, Samsung Electronics succeeded in commercializing 64-kilobit Dynamic Random Access Memory (DRAM) in 1983. The company repeated this feat for 250-kilobit DRAM in 1984, 1-megabit DRAM in 1988, and 4-megabit DRAM in 1989, catching up with Japan, the leader in the global semiconductor industry. Semiconductors grew into South Korea's biggest export industry. In the late 1980s exports of video recorders reached a similar level to those of color televisions. Besides semiconductors, exports of computers and other industrial electronic devices also boomed.

South Korea put in place social security systems at around the same time that it hosted the Olympics. Laws on school lunch provision and livelihood protection were enacted in the early 1980s, while the National Pension Act and the Minimum Wage Act were enacted in 1986 and came into force in 1988. The government also introduced

benefits for the elderly and people with disabilities, established a community health insurance system, and constructed homes for rent.

### ***6. Rising Wages Dent Korean Competitiveness***

The South Korean economy at the time of the Seoul Olympics was marked above all by wage rises and frequently occurred labor disputes. The relaxation of restrictions on labor activity following the 6.29 Declaration of democratic reforms in June 1987 led to a rapid expansion of the labor union movement. Whereas there had previously been an average of 100 to 200 labor disputes per year, in 1987 there were more than 3,700. At the beginning of the 1990s, however, the number stabilized at around 200. As workers' awareness of their rights dramatically increased, lobbying by labor unions yielded major improvements in wages and working conditions.

Until 1986 wages in South Korea stood at \$1.45 an hour, the lowest level of any emerging Asian country or region. With the labor movement increasingly active, wages rose by an annual average of 26.4% between 1988 and 1990. South Korean workers earned \$4.16 an hour in 1990, about three times as much as in 1986 and more than the average \$3.65 earned by workers in Taiwan, Hong Kong, and Singapore. Meanwhile, a 1989 legal revision shortened the legal hours from the 1988 figure of 48 hours to 44.

In addition to the establishment of a minimum wage system in 1988, another factor behind the rapid rise in worker's pay was the rapid fall in the number of people aged around 20 in the labor force as rising incomes pushed up the college matriculation rate. This phenomenon was especially pronounced in manufacturing, construction, and other labor-intensive industries, such as textiles, clothing, and electronics.

Having been sustained by low wages and long working hours, South Korea's international competitiveness took a hit from rising labor costs; exports were sluggish from 1990–91 onward, while the country's trade deficit ballooned. Meanwhile, rising incomes fueled a consumer boom and a sharp rise in real estate prices. With a major government housing plan also launched around this time, demand from both the public and private sectors caused the construction boom to overheat.

### ***7. China Also Witnesses Heavy Industry Growth and Rising Incomes***

Let us compare China today with Japan and South Korea at the time when they hosted the Olympics.

China, like Japan and South Korea before the Olympics, is also experiencing rapid economic growth, with 2007 marking the fifth straight year of double-digit expansion (figure 4). The first point that the three countries have in common is that they all followed the path of developing heavy and chemical industries and expanding exports. The development of China's heavy and chemical industries can be seen clearly in the rapid growth of its steel, automobile, and chemical sectors. Between 2000 and 2006, crude steel production in China became 3.3 times from 128.5 million tons to 419.14

million, car production rose by 250% from 2.07 million vehicles to 7.27 million, and ethylene production doubled from 4.7 million tons to 9.4 million. China's GDP export ratio stood at 36.9% in 2006, higher than Japan's 1964 figure of 22.5% and South Korea's 1988 figure of 32.3%. Industrial products accounted for some 74% of China's 2006 exports.



Source: China Statistical Yearbook

The fact that China has expanded its exports on the back of a currency system that effectively fixes its exchange rate is another point that the country shares with Japan at the time of the Tokyo Olympics. The same goes for its circumspect approach to capital liberalization. All three countries are pursuing trade liberalization. China opened up its domestic market when it joined the World Trade Organization in 2001 and also opened its financial and service markets by 2006, in line with a commitment made when it joined the WTO.

Japan hosted the Olympics in the middle of its Income Doubling Plan, while South Korea did so amid rapidly rising wages. In China, too, the administration of President Hu Jintao and Premier Wen Jiabao has made improving livelihoods a top priority and, at the seventeenth National Congress of the Communist Party of China held in October 2007, set the goal of quadrupling per capita GDP from the 2000 level by 2020.

Rising incomes, as symbolized by the boom in car ownership, is another common denominator. The car diffusion rate in Chinese cities climbed from 0.5% in 2000 to 3.4% in 2005 and 4.3% in 2006 (figure 5). Color TVs, which were a rarity among Japanese households at the time of the Tokyo Olympics, are already commonplace in Chinese cities.

**Figure 5. Diffusion Rates for Consumer Durables in Japan and China**  
(%)

	Refrigerators	Washing machines	Air conditioners	Cameras	Cars
Japan (1964)	63.7	78.6	2.3	79.9	6.8
China (urban) (2006)	91.8	96.8	87.8	48.0	4.3
China (rural) (2006)	22.5	43.0	7.3	4.2	—

Sources: Japan Statistical Yearbook, China Statistical Yearbook

The rapid development of infrastructure that Japan witnessed in the 1960s, including the construction of the Shinkansen and the expressway network, is now occurring in China. Using Shinkansen technology exported from Japan, speeds are being increased on the country's major railroad lines. While China had 1.4 million kilometers of roads in 2000, by 2006 this had become 2.5 times to 3.45 million km, and the total length of the country's expressways increased by 180% from 16,300 km to 45,300 km over the same period. The boom in the construction of high-rise condominiums in urban areas and the steep rise in real estate prices echo the situation in South Korea at the time of the Seoul Olympics.

Urban air pollution caused by the rapid proliferation of cars, river pollution caused by growth in heavy and chemical industries, and the increasing severity of traffic congestion and other urban issues are also problems that Japan and South Korea faced during their high-growth eras.

### ***8. Widening Disparities and Inadequate Social Security System Pose Problems for China***

**Figure 6. Comparison of China Today and Japan and South Korea When They Were Olympic Hosts**

Per capita GDP	China (2006) \$1,998	Japan (fiscal 1964) \$3,051	South Korea (1988) \$4,465
Gini coefficient	China (2004) 0.47	Japan (1962) 0.39	South Korea (1988) 0.30
Unemployment rate	China (2006) 4.1% (rate of urban registered unemployed)	Japan (1964) 1.1%	South Korea (1988) 2.5%
Household	China (2006)	Japan (1964)	South Korea (1988)

savings rate	26% (urban areas), 21% (rural areas)	17%	31%
Foreign currency reserves	China (end of 2006) \$1.0663 trillion (\$1.4336 trillion at the end of September 2007)	Japan (1964) \$1.999 billion (\$945.601 billion at the end of September 2007)	South Korea (1988) \$12.378 billion (\$257.29 billion at the end of September 2007)
Trade balance	China (2006) +\$177.5 billion	Japan (1964) -\$1.264 billion	South Korea (1988) +\$8.885 billion
GDP export ratio	China (2006) 36.9%	Japan (1964) 22.5%	South Korea (1988) 32.3%
Cars per household	China (2006) 0.04	Japan (1964) 0.07	South Korea (1988) 0.1

Source: Compiled by the author from various materials

What, then, are the differences between China today and Japan and South Korea when they were Olympic hosts? First, while Japan had achieved full employment at the time of the Tokyo Olympics, China's rate of urban registered unemployed alone stands at 4.1%, according to 2006 statistics (figure 6). There are also around 10 million unemployed who have been laid off by state enterprises, not to mention the massive labor surplus found in rural villages. China must maintain a high rate of growth to create employment for the 10 million new entrants who join the labor market each year.

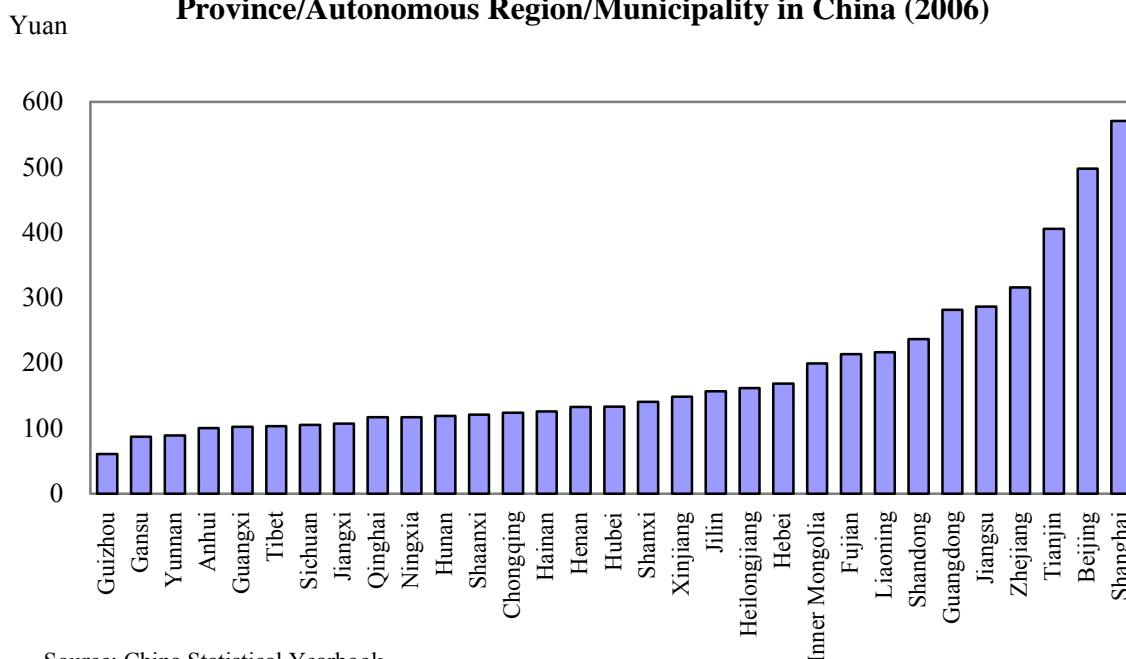
Yet Chinese society is set to age rapidly, with the total population expected to begin falling in around 2030, by which time the working population will already be in decline.

In mid-1960s Japan, income disparities were narrowing as people migrated from rural to urban areas and small and medium-sized businesses raised the wages. Widening income disparities are now a major problem in China. Whereas in 1964 the gross regional product of the highest-ranked Japanese prefecture by this measure was only 4.2 times that of the lowest, in China the equivalent figure was 9.4 times in 2006 (figure 7). China's Gini coefficient, a measure of inequality, was 0.47 in 2004, higher than both Japan's 1962 figure of 0.39 and South Korea's 1988 number of 0.30. The per capita GDP of China as a whole stands at \$1,998 (2006), significantly lower than Japan's \$3,051 (1964) and South Korea's \$4,465 (1988). While China's big coastal cities are already on a par with newly industrializing economies by this measure, rural areas lag far behind. This shows that the foundations of social stability remain fragile in China compared with Japan and South Korea at the equivalent times.

When Japan and South Korea hosted the Summer Olympics, they were just entering the stage at which their expanding exports would allow them to cease worrying about the international balance of payments "ceiling." China, however, already has a consistent—and growing—trade surplus, and this combined with foreign direct

investment has enabled it to surpass Japan to become the world's second largest holder of foreign currency reserves. Intervention to keep the yuan from rising too far under China's managed floating exchange rate system has caused excessive liquidity, and this is one of the factors behind the country's stock and real estate bubbles.

**Figure 7. Per Capita Gross Regional Product by Province/Autonomous Region/Municipality in China (2006)**



There are also differences in terms of social security systems. In 1964, Japan had already established universal health care and other social security infrastructure. South Korea, too, had almost finished putting in place social safety systems in 1988. China's social security framework, however, having been shaken by the dissolution of people's communes and the restructuring of state enterprises, has yet to be rebuilt. Rural villages, in particular, have virtually no social security at all. Anxiety about life after retirement is one of the factors behind China's high savings rate, which has sustained the country's high level of investment.

The vocal calls now being heard in China to save energy and tackle environmental problems echo similar appeals in Japan and South Korea at around the time that they hosted the Olympics. In China's case, however, local governments' emphasis on GDP, distortions in government-controlled energy prices, and a lack of awareness of environmental issues mean that companies and administrators have been slow to act.

Another significant difference lies in the scale of the economic ripple effect of hosting the Olympics. At the time of the Tokyo Olympics in 1964, Tokyo's gross regional product accounted for 18.4% of Japan's GDP, while 10.98% of the country's

population was concentrated in the capital. Beijing, by contrast, is home to just 1% of the Chinese population and its gross regional product accounts for just 2% of the country's GDP, according to 2006 figures. This means that the nationwide ripple effect of the Beijing Olympics is likely to be limited.

### ***9. Japan's Cooperation Essential for Sustaining Stable Growth***

I would now like to chart the likely post-Olympic course of the Chinese economy up to around 2015, based on the experiences of Japan and South Korea. I will consider a standard scenario, an optimistic scenario, and a pessimistic scenario.

#### ***Standard Scenario: Stable Growth with Gradual Progress on Inequality and Environmental Problems***

The standard scenario is that while there are bound to be ups and downs, China will continue its stable growth until around 2015 without experiencing any wild fluctuations. Double-digit growth is unlikely to be sustained in the medium-term, though, so the rate is likely to slow gradually.

Although the process will take time, China will slowly put in place the foundations of social stability that Japan had already completed when it hosted the Olympics, through such means as alleviating income inequality and building social security systems. Japan's experiences, such as the role of agricultural cooperatives and policies to foster small and medium-sized businesses, are likely to be useful in this process. The demographic shift from rural villages to big cities will also take place over time, thus avoiding the kind of upheaval that sudden population movements can cause. China will also gradually resolve the problems of unemployment and the rural labor surplus. It will avoid major economic fluctuations by liberalizing foreign exchange and capital flows in a cautious and measured manner. While it may experience temporary energy shortages and environmental degradation, China will make gradual improvements in the fields of energy efficiency and environmental problems, learning lessons from the experiences of Japan and others. The overall effect of these advances will be to make China a stable society.

Of course, along the way China may experience temporary economic slowdowns and localized disturbances, such as protests by citizens expressing dissatisfaction at income disparities and environmental pollution, but the Communist Party leadership will mobilize all of its resources to implement policies aimed at achieving social stability. It will also be essential for Japan to cooperate by providing expertise in various fields. Despite the likely twists and turns, the probability of this standard scenario becoming reality is high. The results would have a relatively positive effect on both Japan and the global economy.

#### ***Optimistic Scenario: Correction of International Payments Imbalance Through High Growth***

The optimistic scenario is that China will sustain a relatively high level of growth

through to around 2015 and will achieve a smooth shift of the labor force from rural to urban areas by building urban infrastructure and promoting service industries, thus narrowing income disparities. Learning from Japan's experience, it will establish social security systems at an early stage. Against a backdrop of solid, stable growth, China will also liberalize foreign exchange and capital flows in a relatively short time, enabling it to correct its international payments imbalance. The country will also achieve swift results in energy saving and environmental issues, thanks to the effects of systemic improvements and financial subsidies.

This scenario requires that the global economy, especially the US economy, continue to grow steadily and that the Chinese government pursue further reforms solidly rooted in free-market principles in the financial and other sectors, as well as making vigorous efforts to reduce disparities and improve systems related to energy saving and environmental protection. It is also important for the Communist Party leadership to exercise strong leadership and for regional governments to understand and cooperate with the direction set by the central government. In reality, however, regional governments frequently pay little attention to central government policies and focus instead on their local interests, such as tax revenue and employment. It is also unclear whether the global economy, with the United States at its center, will continue its stable growth in the medium term. The chances of the optimistic scenario becoming reality, therefore, are not very high. If China did reach a situation like this, though, it could become a new engine of global economic growth.

#### *Pessimistic Scenario: Severe Unemployment Due to Falling Growth Causes Upheaval*

Finally, the pessimistic scenario is that China's growth rate falls for some reason, exacerbating the unemployment problem and hitting consumption. Possible triggers include the collapse of China's stock and real estate bubbles and stagnation in the US economy. Given the lack of progress in tackling inequality and environmental issues, it is conceivable that China could be swept by demonstrations or even riots against the government. With no leeway to pursue reforms, the government would put off the liberalization of foreign exchange and capital flows and the establishment of social security systems. In the worst case scenario, China's financial sector would slide into chaos as ballooning bad debts at state-run commercial banks and other institutions caused a run on the banks by ordinary citizens.

Although this pessimistic scenario is not likely to become reality, the possibility of this happening cannot be discounted. Compared with the experiences of Japan and South Korea, China's progress in putting in place the conditions needed for social stability, including equalizing incomes and establishing social security systems, remains inadequate. Consequently, any slowdown in economic growth carries the risk of triggering a sudden outpouring of public discontent. Such a development would deliver a major blow to Japan and the global economy. To avoid this scenario, it is essential for Japan to assist China in the construction of its social security systems and other challenges.

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