China's Rise in GDP Ranking

By Noboru HATAKEYAMA

Last year, Japan was replaced by China as the world's second largest economic power in terms of GDP. More accurately, China's "nominal GDP" measured in the US dollar (hereafter GDP means nominal GDP measured in the US dollar unless otherwise specified) exceeded that of Japan, which had been in that position since 1968. I would like to express my congratulations to China on this rise and offer my personal views on the prospect of this issue, focusing on implications for Chinese development and on countermeasures to be taken by Japan.

First of all, will China catch up with the United States in terms of the size of GDP? Assuming both economies will grow at the same rate as they did during the five years between 2001 and 2006 (because the growth rate after 2007 is supposed to be irregular due to the economic crisis), China will overtake the United States in 2021, only 10 years from now. Will China keep its one-party dictatorship system until then and even after that? If that is the case, it will mean that the largest economy in the world will not necessarily be under a genuine free enterprise system.

That new situation with China being No. 1, especially combined with the fact that during the economic crisis, many countries nationalized private companies, including GM of the United States, may tell us at least some changes in the management of capitalism will be taking place. In this regard, the state capitalism that was supposed to be dead with the end of the Cold War seems to have revived. Whether it will gain momentum is one of the most interesting issues in an era of China's rise.

Another question is whether Japan can keep the No. 3 position in the GDP ranking for a while. The GDP of Japan in 2009 was 52% larger than that of Germany, the No. 4 economy. Germany's GDP increased 9.07% annually on average between 2001 and 2006 whereas Japan's recorded only 1.27% annual growth during the same period.

If we assume simply that both the Japanese and German GDP will grow at the same rate as in the period mentioned above, German GDP will pass that of Japan in 2015. If the same simple calculations are made for other countries' GDP growth rates, Japan will be passed by France and Russia in 2016, by Brazil, Spain, Britain and Italy in 2019 and by Turkey in 2021. Thus, if the past trend continued for the next 10 years, Japan would disappear even from the best 10 list of the world GDP ranking, let alone No. 3.

One measure for Japan to avoid this miserable scenario is to improve its per capita GDP.

GDP (A) consists of population (B) x per capita real GDP (C) x deflator (D) x exchange rate (E). To increase A, all these factors or B, C, D and/or E should increase. However, B is decreasing in Japan. This country has been suffering deflation or a situation close to it for a long time. So D is not increasing. In terms of the yen's exchange rate to the dollar, whenever it rose, Japan's exports decreased quantitatively but increased when it was measured in the US currency. So increasing E had and will have mixed impacts on the change of A.

Therefore, the only reliable measure will be to boost C, which is equivalent to the population's per capita productivity. Even when productivity does not rise in each segment of the economy, Japan's productivity as a whole can rise if the share of high-productivity industries increases in its total economic output. Furthermore, the population can be divided into workers and non-workers. Although C is the population's per capita productivity in this essay, only workers contribute to producing GDP. Therefore, if non-workers such as some females and aged people or even youngsters start working, Japan's productivity as a whole will increase.

Of course productivity per se will rise by introducing new technologies and exposing the protected agricultural industry to foreign competition, for example. Although Japan has a very open trade policy for industrial products, it has very high tariffs when it comes to agricultural goods such as rice. However, the Democratic Party of Japan has introduced the so-called individual household income support system in which the government compensates in principle the gap between sales prices of agricultural products such as rice and production costs thereof. If this new system is applied only to cases where sales prices of agricultural products fall due to Japan's concessions in WTO-led trade negotiations or FTA talks including the TPP, it will serve as an excellent measure to cope with trade liberalization, encouraging farmers to combine piecemeal tracts of farmland into larger ones for greater productivity.

Japan should take advantage of this opportunity for an counterattack by prioritizing the enhancement of its economic productivity. JS

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