Lights and Shadows in the Chinese Economy

By Amano Shin-ya (Part I) and Yabuuchi Masaki (Part II)

Part I. China's Economic Development and Risks of Investment in China

Introduction

There is an ongoing debate over whether China's economic development is a threat, but I do not believe that it is. While an overly optimistic view toward China's economic development should be avoided, acknowledging the benefits that China's economic development will have for Japan will be of greater significance in the future. This is an issue that requires Japan to take an extremely practical and strategic approach.

China's economic development, which thus far has been riddled with many problems, is beginning to move in roughly the right direction. In the 1990s, China experienced a spectacular annual average growth rate of about 9.7%. At the end of 2001, China was finally allowed to join the World Trade Organization (WTO). This was a major victory for China, as well as Japan and many other member nations and various firms, which from the beginning had strongly hoped for China's accession to the WTO. The Chinese government will begin implementing the commitments contained in the WTO charter according to a prepared schedule, but many Japanese businesses have already started the third boom of investment in China in anticipation of the investment environment reforms that are expected to be implemented there.

However, the sense of bewilderment towards China's rapid economic development which has erupted from many directions inside Japan cannot be ignored. China's dramatic economic growth has caused speculation about a "Chinese threat" that would harm Japan's national interests. With the massive influx of cheap "made in China" products, industrial groups representing such sectors as Japanese agriculture and textiles have begun to petition the government for response measures to avoid trade friction. A typical example can be seen in the 2001 launch of provisional safeguards by the Japanese government for three agricultural products – stone leeks, fresh *shiitake* mushrooms and rushes used to weave *tatami* mats, and many believe that there is a high likelihood of similar problems in the future. Also, because large firms are strengthening their production bases and expanding their businesses in China, an increasing number of parts suppliers, most of which are small and medium-sized enterprises, are moving their production bases to China as well. In other words, there are concerns about the "hollowing out" of industries and technologies.

Part I of this article will focus on the rapidly growing investment in China by Japanese firms, and will analyze the current status and characteristics of this investment based on the results of various surveys and studies. It will end with a discussion of topics ranging from the management issues being faced as Japanese firms move into China to the business risks involved in such investment.

Rapidly Increasing Japanese Investment in China

Japanese firms have already seen two investment booms in China. The first was the period of yen appreciation from 1985 to 1987. The second was after the 1989 Tiananmen Square incident, from 1990 to 1995, when Deng Xiaoping's call for an accelerated pace of the reform and opening-up during his visit to south China (1992) created a rush of new investment.

Later, however, investment in China by Japanese firms stagnated, falling year on year for four successive years starting in 1996 on a contract basis, and for three years starting in 1998 on an implemented basis. In addition to the prolonged recession in the Japanese domestic economy, the following factors have contributed to this situation.

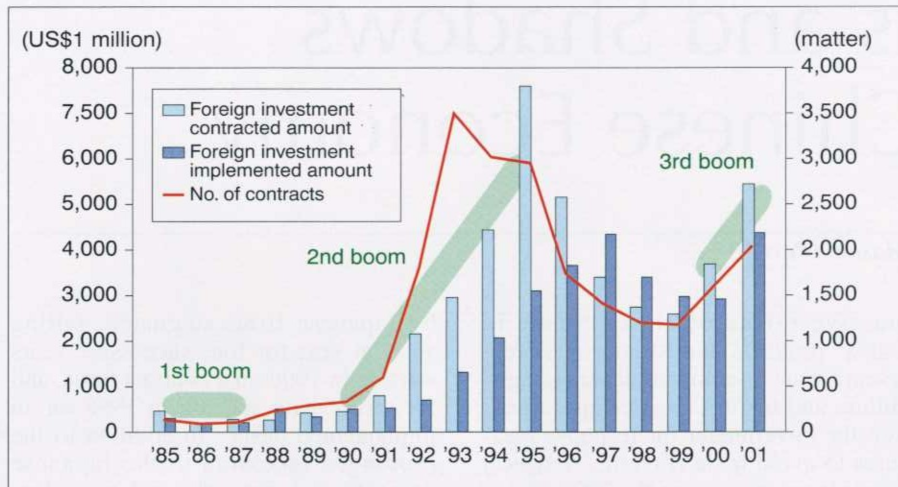
The first is the influence of foreign investment acceptance guidelines which were provided by the Chinese government in 1995. These guidelines controlled the import of foreign investment in existing industries that were meeting domestic demand and labor-intensive industries, and called for the review of some incentive systems. This severely rocked the bases upon which Japanese firms made their foreign investment decisions, thereby inviting a major backlash.

Notions about risk of "yuan devaluation" which had taken root following the 1997 Asian currency crisis, and growing financial uncertainty due to the bankruptcy of the Guangdong International Trust and Investment Corp. (GITIC) in 1998 further put the brakes on the desire of Japanese firms to invest in China.

The will to invest was rekindled among Japanese firms during China's WTO negotiations at the end of 1999 when an agreement was negotiated with the United States, the staunchest opponent of China's entry into the organization. In 2000, the number and value of contracts, a leading indicator of foreign investment, both started to climb upward, and in 2001, foreign investment on an implemented basis soared upward to $4.35 billion (up 49.1% from the previous year). In no time at all, new records were set. (Figure 1)

According to the Ministry of Foreign Trade and Economic Cooperation (MFTEC), investment in China by Japanese firms from January to March

Figure 1 Trends in Japan's direct investment in China



Source: Almanac of China's Foreign Economic Relations and Trade

2002 on a contract basis amounted to 537 contracts (up 36% year on year) valued at $2 billion (up 26.4% year on year). On an implemented basis, it amounted to $870 million (up 13% year on year). The rising trend has continued even into 2002.

Japanese Firms Aim to Expand Production and Strengthen Sales in China

How should the increasing investments in China by Japanese firms be characterized? Liu Zuozhang, Deputy Director General of the MFTEC's Foreign Investment Administration, analyzes the current situation, "The reasons why foreign investment in China is increasing are that firms in various countries realize: (1) China's economy is going to continue to experience steady economic growth; (2) overall, China offers extremely low costs and product price competitiveness; and (3) the investment environment is going to improve because of China's accession to the WTO. A number of Japanese firms are increasing their investment in China in order to prepare for establishing large-scale production bases there." [1]

A survey conducted by the Japan External Trade Organization (JETRO) in October 2001 on the "Current Status of and Outlook for Foreign Direct Investment Strategies Among Japanese Firms" indicated that Japanese firms are indeed looking at China as a priority target for their investments.[2] Of the 300 firms that indicated they were planning (or considering) to increase foreign direct investment over the next three fiscal years (2002 to 2004), 287 (or 95.7%) included China as an investment target.

It is especially interesting that 80% of the firms that indicated an investment interest in China also indicated an investment interest in the Association of South-East Asian Nations (ASEAN) countries. In other words, while China is currently preferred over ASEAN as an investment target for Japanese firms in terms of market growth potential and costs, there is not a unilateral concentrated interest in China. Rather, there are active efforts to search for the optimal production site in Asia by supplementing investment in the ASEAN nations, where there has been a great deal of past investment, with investment in China.

Among these firms, the most often cited purpose of investing in China (multiple answers permitted) was "to expand production and sales in the target investment market" at 71.1%, followed by "to reduce costs" at 44.9%, "to respond to overseas movements by our client/vendor companies within Japan" at 24.7%, and "to expand sales into a third country" at 18.8%.

Japanese firms' main businesses in China have conventionally taken advantage of the nation's cheap labor, and used the Chinese market as a base for consignment processing, production, or export. Today, however, investment in China by Japanese firms is being made to expand conventional businesses as well as existing production bases and to strengthen sales in China.

Increasing Competition Raises Local Procurement Rates

Now we shall examine the current status of Japanese firms' businesses in China. According to the "Survey of Japanese-Owned Manufacturers in Asia" conducted by JETRO in November and December 2001, among the 630 firms that have expanded into China, the number of companies whose products are mainly oriented for exports (with export rates of 70% or higher) was 302 (48%). This figure is higher than the one for domestic sales-oriented firms (with a domestic sales ratio of 70% or higher) of 239 (38%). However, looking at the local procurement rates, while most of the export-oriented firms rely on imports of raw materials and parts from Japan, as many as 60% of the domestic sales-oriented firms indicated that they have a local procurement rate of 51% or higher. In positive contrast to the Japanese-owned firms that have moved into the ASEAN nations, the domestic sales-oriented firms that have moved into China will have to further raise their levels of local procurement to be able to survive stiff competition in the domestic market.

Specifically, Japanese firms plan to invest and make their mark in high value-added products, primarily in the fields of electrical appliances and automobiles. There are plenty of movements aimed at securing market share in the Chinese domestic market, and the major manufacturers are being followed by major parts makers in their efforts to get into the market. Because, generally speaking, local Chinese firms and Taiwanese firms compete to supply general-purpose parts at a low price, Japanese-owned parts manufacturers have little choice but to specialize in high-value-added key components. Japanese-owned parts manufacturers continue to be competitive in the core components of high-tech products. With downward pressure on finished

product prices, there are strong expectations among Japanese-owned firms as well as European and American firms in China, that Japanese parts manufacturers will make the move into China as well.

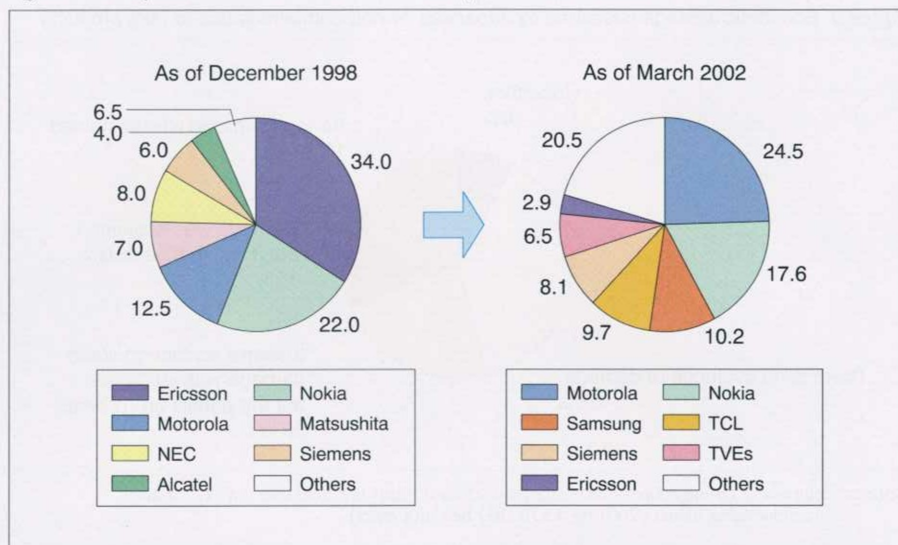
Domestic Sales Strategies to be Learned from European and American Firms

So what does the Chinese domestic market look like? In the Chinese domestic market, local manufacturers like Haier and Legend take a large share from Japanese firms in the sectors of electrical appliances, such as televisions and air conditioners, and in parts of the information technology (IT) sector such as personal computers. Also, European and American firms are dominant in sectors like petrochemicals, distribution, high-tech devices (mobile phones, telecommunications equipment) and automobiles. (Figure 2) Unlike the Japanese firms whose mainstay has been their export-oriented businesses, European and American firms in China have adopted a strategy of developing businesses that target domestic demand.

Particularly in the late 1990s, when investment in China among Japanese firms stagnated, European and American firms rapidly developed a presence in the Chinese market by continuing their large-scale investments. The ratios of total investment in China (on an implemented basis) among Japan, the United States and Europe show that while the Japanese share dropped from 8.3% in 1995 to 7.2% in 2000, the share increased for the United States from 8.2% to 10.8% and for Europe from 5.7% to 11%, indicating the relative expansion of the presence of American and European firms in China.[3]

A comparison of the value per investment indicates that the amounts invested by European and American companies are larger than those invested by Japan. While the value per investment from 1995 to 2000 (on a contract basis) was $2.5 million for Japan, it was $2.6 million for the United States and $5.6 million for Europe. The reason the figures for Europe are so much higher is the heavier weight assigned to large-scale investment by multinational firms.

Figure 2 Comparison of market share of mobile phone manufacturers



Source: Compiled by materials from CCID

In other words, for Japanese firms to strengthen their sales in the Chinese domestic market, they will have to cultivate and recapture parts of the domestic market that have already been taken by Chinese, European, or American firms. The Japanese firms that are really beginning to pour their efforts into domestic sales businesses in China have a lot to learn from the business strategies adopted by the European and American firms that have successfully developed their shares in that market (strategies such as forming alliances with local Chinese firms, establishing research and development (R&D) bases and setting up parts procurement centers).[4]

Management Issues Faced by Japanese Firms and Risks of Investment in China

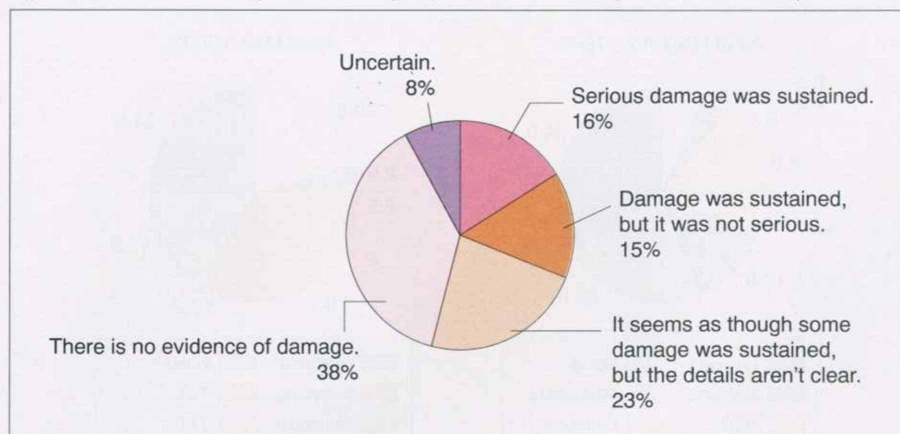
Finally, let's examine the management issues being faced by Japanese firms and the risks involved in investment in China. Attorney Ishimoto Shigehiko from the Beijing Office of the Mori Sogo (general) law offices warns that "Japanese firms have not done enough to handle individual problems regarding legal management." China is striving to become a constitutional state by joining the WTO, but it is important not to forget that business risks still exist. Minimizing risks requires careful attention and policies to prepare for worst-case scenario situations.

Various surveys have indicated that the management issues faced by Japanese-owned firms include: (1) dealing with fake products; (2) product liability issues; and (3) collecting credit sales. Of these, the damage caused by fake products has become quite serious. According to a survey conducted by JETRO in November 2001,[5] 54% of responding firms had sustained some kind of damage due to fake goods, and half of the firms indicated that "the problem of fake products is worsening." (Figure 3) Also, 32% of the firms that had sustained damage from fake products had suffered "¥100 million or more in damages." (Figure 4)

An increasing number of Japanese firms are investigating ways to introduce high-value-added products in the marketplace for the purpose of distinguishing themselves from European, U.S. and local Chinese firms. For Japanese firms to be able to take full advantage of the technologies they hold and to make a profit in China, it is absolutely essential that they develop policies for dealing with imitations. Japanese firms need to take a resolute stand on addressing this problem.

Yokogawa Electric Corp. is a prominent Japanese manufacturer of measur-

Figure 3 Economic damage sustained by Japanese-owned companies due to fake products



Source: "Survey of Damage Sustained by Japanese-Owned Firms in China Due to Fake Products" (conducted in January 2001 by the JETRO Beijing Center)

ing instruments and control systems that has become the leading measuring instruments manufacturer in China in the seven short years since it started out there with a joint venture in Chongqing, an inland Chinese city. Watanabe Noboru, a general manager with Yokogawa, says that the keys to success in investing in China are "having a clear purpose for why you want to move into China and finding outstanding personnel. ... The flip side of the accelerating boom of investment in China is the risk of litigation. Companies can suffer unexpected losses if they are unfamiliar with Chinese laws and social customs, and it is thus necessary that they pay close attention and undertake careful research before investing."

With the pace of investment in China accelerating and competition growing more fierce, Japanese firms need to take aggressive efforts to: (1) prepare for the continuing risks of doing business in China; (2) facilitate thorough localization of their businesses by such measures as training and using local human resources; and (3) rebuild an investment strategy for China from a long-term perspective.

(This is an edited version of the article entitled, "Rapidly Increasing Investment in China and Issues Faced by Japanese Firms," *JETRO Sensor*, August 2002.)

Notes:

1. *Japan-China Investment Promotion Organization News*, May 31, 2002.
2. 2001 "Current Status of and Outlook for Foreign Direct Investment Strategies Among Japanese Firms at the Dawn of the 21st Century," survey conducted among 2,567 Japanese firms (response rate of 28.0%).
3. In 2001, since investment in China among Japanese firms suddenly increased, the share of each country in the total foreign investment in China was 9.3% for Japan, 9.5% for the United States and 8.9% for Europe. These figures indicate that Japan is recovering its presence in China.
4. "Keys to Successful Business in China That Can be Learned from European Multinational Firms," UFJ Bank, April 2004.
5. Conducted among 3,256 Japanese-owned firms with offices throughout China, including Beijing, Shanghai, and Guangzhou. Response rate of 20.6%.

Part II. Factors That Restrain the Chinese Economy

An inflow of foreign investment, mainly in the manufacturing industry, has been the driving force behind economic growth in China. At the outset, Japanese manufacturers utilized China as a processing base for exports, but with Japan facing economic recession and confronted with an economic crisis in Asia, interest in China as the next growth market had risen by the end of the 1990s. More and more foreign investment is now focused on ensuring participation in this market. Although WTO membership generated even greater interest in the Chinese market, the question of whether or not market growth will live up to expectations comes down to the country's social and political stability and continued, balanced development in those aspects of the Chinese economy unrelated to foreign investment.

The Chinese socioeconomic climate in areas unrelated to foreign investment inflow is, in fact, beset by a multitude of issues. The Communist Party's sustained hold on political power is based on the fact that, under Deng Xiaoping, it was able to bring economic development to a China worn down by the Cultural Revolution. The shadow of economic growth, however, has not only obscured a number of existent problems, but this growth has also generated additional problems such as the economic gap now emerging among Chinese people.

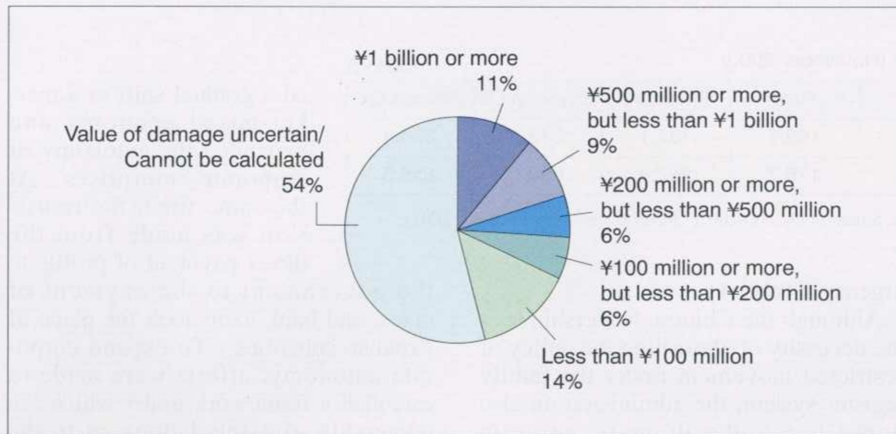
The Communist Party administration will lose the trust of the Chinese people if it cannot effectively deal with the problems the country faces today, and a loss of trust would undermine the country's political stability. Political destabilization would discourage continued investment of the foreign capital that has propelled growth to date, and Chinese economic development would inevitably stagnate.

Evolution of Economic Restraints

The socioeconomic problems that confront China today are both geographic and historic in nature. Issues based on historical factors include those problems generated in the process of the country's transition from its recent past to the present, as well as from a planned economy to a market economy.

Geographically, the country's land of expansive and fertile plains have sustained an increasing population, which is now closing in on the limit of what their land can provide. The increase in population has also resulted in environmental pollution and the devastation of forests that nurture the sources of water supply. More recently, desertification

Figure 4 Value of economic damage sustained by Japanese-owned companies due to fake products



Source: "Survey of Damage Sustained by Japanese-Owned Firms in China Due to Fake Products" (conducted in January 2001 by the JETRO Beijing Center)

has extended as far as 80km from Beijing, and certain areas north of the Yellow River are plagued with chronic water shortages.

The country's belated start in building an industrial infrastructure can be attributed to historical factors. Low productivity is a problem not only in industry, but in agriculture, finance, distribution and a multitude of other sectors, as well. Each of these sectors remains at a low level of development. Although China has aggressively introduced foreign investment in an attempt to bring its industrial infrastructure up to speed, the majority of national industries still fall short of the mark. Moreover, China is now facing newly emerging issues. Namely, foreign capital-driven economic development juxtaposed against the stagnation of national industry, and the geographic inequality of foreign capital distribution, are serving to expand the coastal-inland and urban-rural economic gaps.

The Gini coefficient, a measure used to illustrate the degree of inequality in income distribution, stood at 0.21 for rural areas and 0.16 for urban areas in 1978, the year the open market reform policy was introduced, and these figures have risen alongside economic growth. At the National People's Congress in March 2001, Premier Zhu Rongji reported that, "At 0.458, China's Gini coefficient is higher than in Europe. It is, in fact, close to the coefficient in the United States and has exceeded the international warning level set at 0.4."

Agriculture is the least developed of all China's industries. Agricultural issues are linked with population issues, further complicating the situation. Aside from an exceptional case in which a Japanese trading firm supervised the production of vegetables destined for the Japanese market, there are no opportunities for foreign investment in agriculture, which has left this sector at the bottom of the development ladder.

China also faces a shortage of technicians, researchers, lawyers, accountants and other professionals who make up the human resource base necessary for industrial advancement. Valuable human resources tend to leave China for opportunities in foreign lands or end up clustered at foreign capital firms, which only serves to further aggravate the shortage of personnel who would otherwise contribute to advancing the country's national industries.

The ever-present residual affects of the planned economy are also historical in origin. The open market reform policy in place since 1978 calls for the separation of political and economic affairs under which China has remained committed politically to socialism, while pursuing a transition to a market-based economy and the introduction of foreign investment on the economic front. Another contributing factor is the gradual pace at which reforms were introduced. Although the country benefited from the fact that reforms were not introduced at a more rapid pace in terms of maintaining political and social stability, the unhurried pace of reforms has left behind a pervasive residue of the planned economy structure.

Corporations in the original sense of the term did not exist under the planned economy. With 24 years of reform and opening-up behind them, private companies are now operational and a handful of state-owned enterprises have even entered foreign markets. While a small number of state-owned enterprises have been successfully reformed, this has only been accomplished by concentrating total control in the hands of a few prominent capitalists. Despite efforts since the 1990s, corporate structures suited to a market-based economy have not yet taken hold in China.

Sector-Specific Controls

Agriculture

Since the foundation of a socialist China, the government has consistently restricted the movement of the population from rural to urban areas using a family register system. As the country's population has increased, this restriction on movement has left rural areas of China saddled with a massive surplus of labor. Although today's agricultural labor population stands at approximately 300 million, it is estimated that only 100 million are needed to maintain current agricultural production. The area of cultivated land per capita in China is 0.106 hectares (2000), merely 43% of the worldwide average.

While continuing to restrict movement from rural to urban areas under the open market reform policy, the government has encouraged the formation of township and village enterprises (TVEs; rural industries and trading firms) in order to create employment opportunities in rural areas. The 1.52 million TVEs operating in 1978 had increased to 22.03 million by 1995, while the number of persons employed at these enterprises had climbed from 28.27 million in 1978 to 128.62 million by 1999. With inadequate technical and managerial capabilities, however, there is a limit to how much TVEs can

Table 1 International Agricultural Price Comparison (November 2000)

(US$/kg)

	Wheat	Corn	Rice	Soybeans	Soybean Oil	Peanut Oil
International Price	108.6	88.5	162.7	187.1	318.0	694.4
Price of Chinese Produce	136.8	117.8	176.7	257.4	590.1	856.5

Source: "Analysis and Forecast on China's Rural Economic Situation in 2000-2001," *Rural Economy Greenbook*, 2001

grow. Development at these enterprises peaked in 1995, and in 1999, the numbers had dropped slightly to 127.05 million people employed by 20.71 million TVEs.

Although a certain amount of growth in TVEs has contributed significantly to new rural employment opportunities, these enterprises have yet to institute employment or annuity insurance systems for their employees. Farmers employed at TVEs tend therefore to hold onto their farmland as a means for ensuring their future security. The inherent failing in this situation is that growth of TVEs does not lead to broader agricultural management. The Chinese government has only just established a social security system in urban areas, but a similar system is also essential in rural areas if agricultural management is to be developed.

The government's strategic raising of its purchasing prices of agricultural products, thereby increasing farmers' incomes in an attempt to expand the markets of state-owned industries that had fallen into surplus production operations, has pushed the prices for Chinese grains, raw cotton and other products above the international levels. This has undercut the international competitiveness of Chinese agricultural products, and the lower tariffs and reduced import volume limits that go hand in hand with WTO membership will create difficulties for Chinese grain and raw cotton farmers. More efficient agricultural management and new employment opportunities for surplus labor are therefore of the utmost urgency. (Table 1)

Although the Chinese leadership sees the necessity of abolishing the policy of restricted movement under the family register system, the administration also hopes to avoid a dramatic surge in urban migration. A policy has therefore been drafted that calls for the creation of employment opportunities by building a large number of small towns with populations between 200,000 and 300,000 in rural areas and by promoting the manufacturing and service industries in these areas beginning this year. In light of the peak, however, in TVEs in the latter half of the 1990s, a human resource pool of technicians and management specialists must be trained immediately if these small towns and rural industries are to truly create new employment opportunities.

Reforming State-Owned Enterprises

Under the planned economy, state-owned enterprises complied with indicators handed down by government-controlled departments regarding production volume, selling price, usable raw materials, number of employees, salary and other matters. The government covered the necessary expenses, and corporate profits were then paid back to the government. This structure rendered state-owned enterprises nothing more than an executive arm of the administration with absolutely no mechanisms in place for improving productivity. It was this situation that led to the 1980's saying, "There are no corporations in China." (Table 2)

China's open market policy promoted a gradual shift to a market-based economy and expanded the autonomy of corporate enterprises. At the same time, the transition was made from the direct payment of profits to the government to the payment of taxes, and bank loans took the place of expense subsidies. To expand corporate autonomy, efforts were made to establish a framework under which the ownership of assets belonging to the state was divorced from the managerial autonomy of the corporations themselves. In a number of cases, however, corporations have been unable to sufficiently exercise their autonomy under this framework. Companies are not, for example, able to use the holdings of state-owned enterprises as collateral when applying for bank loans without the consent of the governmental department to which these assets belong.

The government is testing two methods of ensuring that corporate governance does not interfere with the autonomy of state-owned enterprises. The first involves public stock offerings in state-owned enterprises and the restructuring of governmental departments into holding companies that have ownership and control over the stock of these state-owned enterprises. The second method involves the formation of corporate groups. These groups are structured around a core company, a state-owned enterprise exhibiting strong performance, which has control over a number of smaller related state-owned enterprises. (Figure 5)

China has not had much success with the first method since the bureaucratic nature of government management has not been completely eliminated from these holding companies, which means that the managerial autonomy of subsidiary companies tends to be no less restricted than before. A certain degree of success, however, has been attained using the second method in instances where the corporate group's core company has competent managers in place. A closer look at these successful corpo-

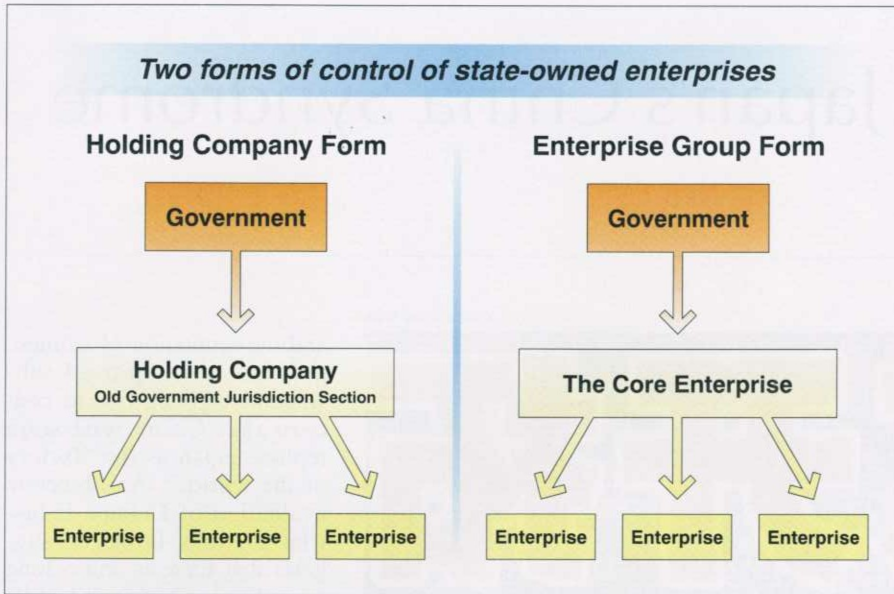
Table 2 International Comparison of Manufacturing Labor Productivity

(US$/worker-year)

China (1998)	US (1995)	Japan (1993)	Germany (1994)	South Korea (1994)	Malaysia (1995)	Indonesia (1996)
3,604	98,253	104,075	85,370	57,666	17,135	9,332

Source: "Comparative Studies between China's Industrial Development and World Leading Standard," *Guo Kesham*, 2001

Figure 5



rate groups, though, reveals that these enterprises are structured so that managers are invested with nearly as much power as corporate owners. This type of structure falls short with regard to corporate governance as it proves difficult to keep managers with a great deal of power from acting in their own self-interest.

The key element for China's successful transition to a market economy is the reform of state-owned enterprises, and as the above illustrates, an adequate framework under which this can be accomplished is not yet in place.

Finance

Approximately 85% of all assets at Chinese financial institutions are owned by national commercial banks, and these banks are saddled with a large amount of non-performing loans (NPLs), owing mainly to the extension of loans to state-owned enterprises. Official reports by the Chinese government cite a 25% NPL ratio, but a closer look at the assessment standards used to classify loans in this category could push this figure up to 30-40%.

The backdrop to the extensive NPL burdening China's national commercial banks pertains to the reforms instituted at state-owned enterprises. Under the planned economy, the government used public finance to provide state-owned enterprises with the capital they needed. With the implementation of economic structural reforms in the 1990s, however, state-owned enterprises were required to procure the necessary capital through bank loans. National banks, however, are essentially state-owned enterprises themselves, and rather than assessing corporate risk in determining whether loans were to be granted, these banks followed government instructions without considering the risk factor in extending loans. With the government stress on bringing state-owned enterprises up to speed by introducing advanced technologies and equipment from foreign countries during the 1990s reforms, national banks were instructed to extend loans to state-owned enterprises looking to finance investments in technology and equipment. Most state-owned enterprises, however, lacked the essential expertise to develop and market products and improve productivity so that their businesses could effectively absorb these capital investment loans. This meant that plant and equipment investment did not boost profits, and bank loans fell in rapid succession into the NPL category.

Despite China's existing stock markets in Shanghai and Shenzhen as a means for direct financing, the issue of insufficient transparency in corporate financial affairs is currently restraining their growth. Reporting only half of total sales is thought to be the norm at privately operated enterprises. An environment conducive to sound corporate accounting must be created, and this would begin with the training and employment of financial and tax experts at both tax collection agencies and accounting offices.

Potential Collapse?

WTO membership will most likely increase the disparity between industry and agriculture, urban and rural areas, successful enterprises and those that will be weeded out. Greater disparity among social and economic elements would naturally rock the foundation of an administration whose goal is a communist society. Can we really assume, though, that these changes would mean the end of the Chinese Communist Party's hold on political power?

Despite obviously greater disparity in income levels, the average income as a whole and standard living of most Chinese people are improving. We can assume that the leadership's power base would be shaken if the absolute standard of living declines for a large enough segment of society, but the socioeconomic situation in China has not yet reached this level of severity. By continuing to attract foreign investment, the government is working to ensure that, even if the income gap does increase, an overall larger economic pie improves the standard of living for an absolute majority of its citizens. Political instability in China would bring an end to the foreign investment that has been the driving force behind economic development to date. It seems, however, that no plans to oppose the government on a scale that would induce foreign investment flight is evident in China today. JJTI

Amano Shin-ya is an assistant director at the Overseas Research Department, China-North Asia Section, Japan External Trade Organization (JETRO).

Yabuuchi Masaki is a director at the Overseas Research Department, China-North Asia Section, Japan External Trade Organization (JETRO).