

World Economic Trend, Spring 2005, No. 7

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(summary)

Part 1 Key Points of Chapter 1

1. Rapidly rising economic presence of China

● Since late 1978, China has been actively making efforts toward a market economy in line with its “open-door” policy. The country has consecutively achieved high economic performance and become a true “economic giant.” At the same time, China’s economic relations with Japan have deepened.

2. China itself needs to change its currency regime

● As its trade surplus with other countries increases, political leaders of major industrial countries have come to frequently call on China to reevaluate the yuan, or to reform the currency regime.

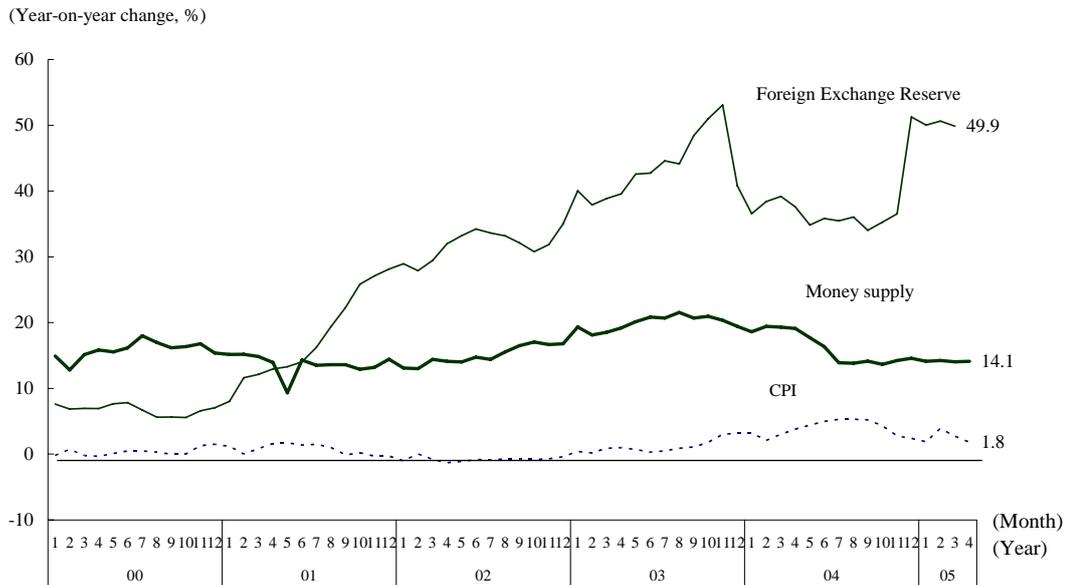
● China has come under criticism that it has been fixing the yuan’s exchange rate at a highly undervalued level relative to the country’s international competitiveness.

● There is no consensus, however, regarding the extent to which the yuan has been undervalued.

● Chinese political leaders have repeatedly stated that the Chinese government has considered introducing more flexibility to the yuan’s exchange rate.

● The reason why the Chinese authorities have an incentive to change the currency regime is that it has become increasingly difficult for the PBC to intervene in the foreign exchange market to maintain the current system and to continue its sterilization policy, while its domestic monetary policy has been losing its independency(Figure 1).

Figure 1 Changes in CPI, Money Supply, and Foreign Exchange Reserve



(Source) National Bureau of Statistics of China, The People's Bank of China, State Administration of Foreign Exchange

- Under its open economy, China has been caught in a trilemma. The following three policy objectives cannot be achieved simultaneously: (1) fully liberalized capital mobility, (2) stability of exchange rate, and (3) independency of monetary policies.
- For countries with a large economy like China, it should be theoretically optimal to combine (1) and (3).
- China will shift to a floating exchange regime in the very long run. But in the mean time, it is necessary for the country to adopt some transitional measures while it facilitates a more market-based robust domestic financial market.
- Each method that has been currently proposed has both merits and demerits. Therefore, it is necessary to understand the characteristics of each method and to adopt measures that combine more than one method in accordance with economic conditions to complement the demerits of each.

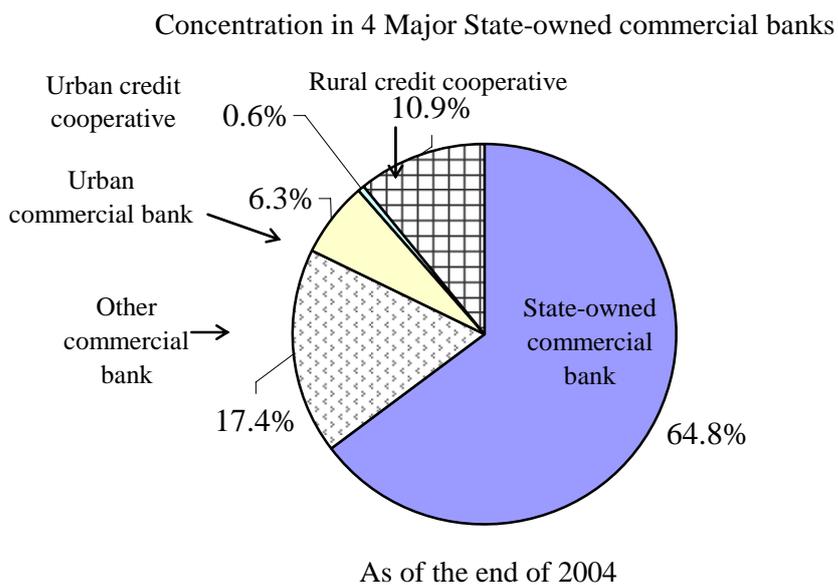
3. Various problems that should be addressed to achieve sustainable economic growth

- Hidden behind the rapid high economic growth, many

structural problems must be addressed seriously in the domestic market to achieve sustainable growth.

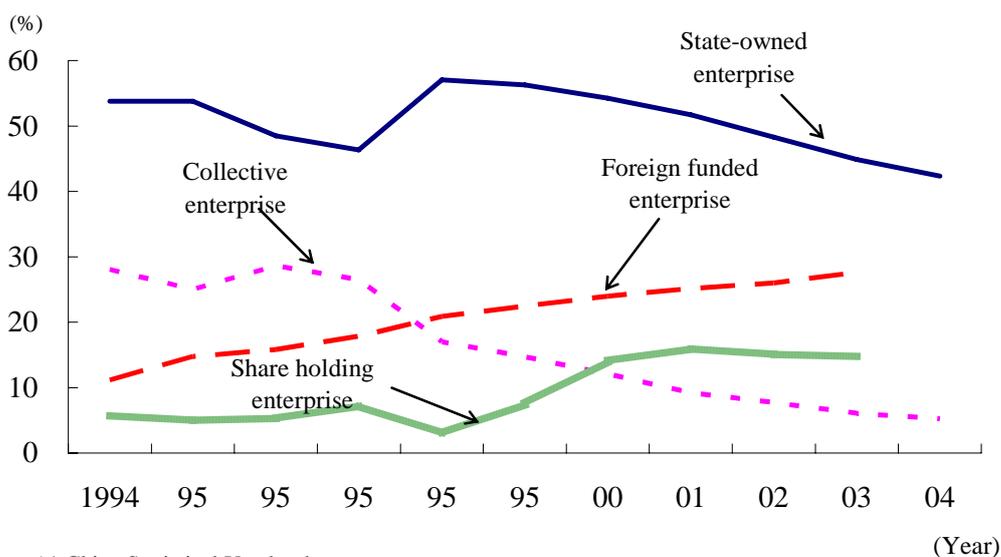
• China has undertaken the long-standing issues of improving management efficiency of state-owned banks and enterprises under intensifying competition, following its entry into the WTO, 2001(Figures 2 and 3).

Figure 2 Financial Institutions' Share (Total Lending Base)



(Source) The People's Bank of China

Figure 3 Changes in the Ratio of Value Added by Various Types of Enterprises



(Source) 1. China Statistical Yearbook

2. State owned enterprises and non state owned enterprises with annual sales of more than 5 million yuan

- **Income distribution disparities between city and rural areas have increased significantly in conjunction with three agricultural problems.**
- **Problems such as constraints on electricity and other energy supplies, and the lack of social capital, may become a bottleneck to future growth.**

Part 1 Key Points of Chapter 2

1. The idea of “from the public to the private”

- **The shift from the public to the private sector had been in place since the 1980s, against the background of expanding fiscal deficits seen in many developed countries. The reduction of costs and fiscal deficits through retrenchment of the government sector has generally been successful.**
- **However, in some cases, the reduction has resulted in erosion of the morale of the government sector and a decline in the quality of administrative services.**
- **Recent efforts show that the focus is how to utilize the private sector to provide better services more efficiently.**
- **This reflects the idea that the ultimate goal is to enhance customer satisfaction through improvement of services regardless of whether the services are to be provided by the public sector or the private sector, and that, therefore, what is important is how to provide services efficiently. The method to provide services has been diversified (Table 4).**

Table 4 Various PPP Methods in the U.K.

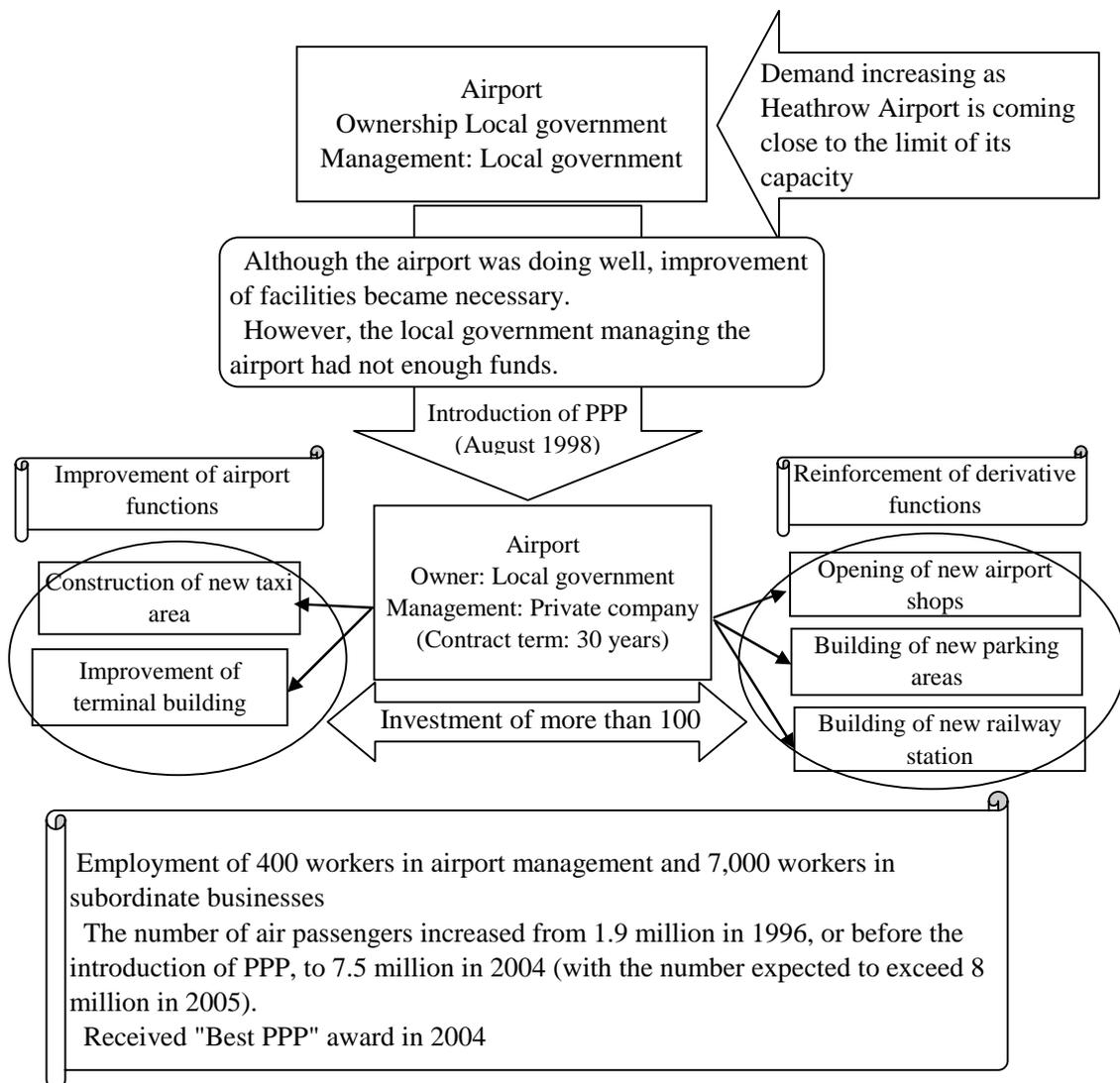
| | | |
|---|---------------------------------|---|
| 1 | Asset sales | Selling public-sector assets and utilizing private-sector financing and management skills |
| 2 | WMI (Wider Markets Initiative) | Creating commercial value by introducing private-sector skills and financing in order to further utilize the public-sector's physical and intellectual assets |
| 3 | Sale of state-owned enterprises | Sale of national enterprises to the private sector |
| 4 | Partnership enterprises | Introducing ownerships of the private sector to state-owned enterprises, while maintaining public interest and public policy objectives |
| 5 | PFI | Having private enterprises provide public services and the public sector purchasing the services |
| 6 | Joint venture | With both the public and private sectors providing funds and know-how, creating long-term interest under joint management |
| 7 | Partnership investment | The public sector invests in investment projects of the private sector to earn returns from the investment |
| 8 | Policy partnership | Involvement of individuals and groups from the private sector in policy planning and implementation |

(Source) The Stationery Office, "Public Private Partnerships :The Government's Approach"

2. New methods for the shift from public to private in other countries

- Since the 1990s, especially since the second half of the 1990s, so-called privatization has become diversified. There have been movements of business operations through public-private collaboration other than in the form of transfer of ownership (Figure 5).

Figure 5 PPP at Luton Airport, U.K.



(Source) Noda (2004) Luton Borough Council

- In addition, a method aimed at enhancing the efficiency of

public services by introducing competition (market test) has come to be used widely, regardless of whether the services are provided by the public sector or the private sector.

- Market tests have been introduced into such countries as the United States, the United Kingdom, and Australia and are being applied to various areas such as management of public facilities and job assistance services for the unemployed.
- Examples show that these methods have led not only to cost reductions, but also to business opportunities and job creation (Table 6).

Table 6 No. of Market Tests Conducted by the U.S. Federal Government and the Amount of Costs Saved

| | Fiscal 2003 | Fiscal 2004 | Total |
|---|---------------------|---------------------|---------------------|
| No. of market tests conducted | 662 | 217 | 879 |
| Streamlined competition | 570 | 116 | 686 |
| Standard competition | 92 | 101 | 193 |
| No. of officials covered (full time equivalent) | 17,595 | 12,573 | 30,168 |
| Streamlined competition | 5,474 | 1,201 | 6,675 |
| Standard competition | 12,121 | 11,372 | 23,493 |
| Net cost reduction (3-5 years) | 1.1 billion dollars | 1.4 billion dollars | 2.5 billion dollars |
| Net cost reduction (annualized) | 240 million dollars | 290 million dollars | 520 million dollars |
| Net cost reduction per head | 12,000 dollars | 22,000 dollars | |

(Source) 1. U.S. Office of Management and Budget "Report on Competitive Sourcing Results (FY2004Update)"

2. Full time equivalent means actual labor input expressed by the number of full-time employees.

3. Challenges in promoting a shift from public to private

- Experiences in foreign countries have revealed two important points: (1) employment measures where retrenchment of the public sector is involved, and (2) existence of a private sector capable of providing valuable services.
- If a reduction in public-sector personnel results in the erosion of morale and a decline in the quality of services—a most undesirable outcome—it will also result in the provision of

better administrative services.

- **Moreover, if entities that are capable of executing businesses do not exist in the private sector, the move from the public sector to the private sector may not make progress.**
- **Case examples in foreign countries show that employment measures are taken to address problems involved in the transfer of operations. There are abundant entities providing administrative services in the private sector.**

Part 2 Key Points of Chapter 1

The world economy in 2005 is expected to grow more slowly than it did in 2004, but it should pick up steadily.

- The growth rate of the world economy, which is believed to have stood at 3.9 percent in 2004, is expected to come down to around 3.2 percent in 2005 due to slower growth of the U.S. and Chinese economies, which have provided most of the drive toward expansion (Table 7).

Table 7 Region-by-Region Economic Forecast by Private Institutions

Real GDP
(Year-to-year change, %)

| Country/region | 2003 (Results) | 2004 (Results) | 2005 (Forecast) | 2006 (Forecast) | |
|------------------|-------------------|-------------------|--------------------|--------------------|-----|
| U.S. | 3.0 | 4.4 | 3.4 | 3.3 | |
| A s i a | NE Asia | 6.7 | 7.3 | 6.7 | 6.3 |
| | ASEAN | 4.7 | 5.8 | 5.0 | 5.2 |
| Europe 4 | 0.8 | 2.1 | 1.4 | 2.0 | |
| (Ref.) Euro area | 0.5 | 2.1 | 1.5 | 2.0 | |
| (Ref.) Japan | 1.4 | 2.7 | 1.2 | 1.8 | |

(Note) 1. Results are from statistics of each country, forecasts are averages of forecasts made by private institutions.

2. NE Asia: China, South Korea, Taiwan and Hong Kong.

ASEAN: Singapore, Indonesia, Thailand, Malaysia, and the Philippines

Europe 4: Germany, France, Italy and the U.K.

3. The GDP growth rates of NE Asia, ASEAN, and Europe 4 are weighted averages of nominal GDP for 2003.

4. Forecasts published by private institutions in April-May 2003

Private institutions: BLUE CHIP (53 companies in 2005, 52 companies in 2006), CREDIT SUISSE, EIU, OEF, JP Morgan, Morgan Stanley, Morgan Stanley, Bank of Tokyo-Mitsubishi, Nomura Securities, Mitsubishi Research Institute, Mizuho Research Institute, Japan Center for International Finance

5. As for Japan, 2003 and 2004 figures are estimates by the Department of National Accounts, Cabinet Office, and 2005 and 2006 figures are estimates published in EPS Forecast (Economic Planning Association) in May

1. U.S. economy expected to reach cruising speed

- The U.S. economy posted a high growth rate of 4.4 percent in 2004, led by robust domestic demand despite higher crude oil prices. There were concerns about the adverse effects of higher crude oil prices. But for the whole of 2004, the upward

pressures on prices were limited.

- In 2005, the economy is expected to post a growth rate of around 3.5 percent, slightly lower than in the previous year, but should still remain above its potential growth rate of 3.2 percent.

- The interest rate, which stood at a historically low level in mid-2004, was raised by 0.25 percentage points on several occasions, while keeping a subtle balance between the maintenance of expansion and considerations of upward pressure on prices.

- The interest rate has been kept unchanged at this level in early 2005, and the rate is likely to be raised close to 4 percent toward the year end against the background of mounting upward pressure on prices.

2. Asia, especially China, is expected to continue to post high economic growth.

- The Chinese economy, which has provided most the drive for expansion of the whole Asian region, posted a high growth rate of 9.5 percent in 2004. In the January-March quarter of 2004, total fixed asset investment in the country posted a year-on-year growth of more than 40 percent, prompting the government to take stringent policies directly and indirectly. As a result, the growth of total fixed asset investment in the second half of the year dropped to slightly above 20 percent, pushing the growth of the country's imports lower as well.

- Since concerns about economic overheating remain unresolved in early 2005, Chinese policy makers have set a growth target of around 8 percent, and have been carefully implementing policies through micro control so that the economy will make a soft landing.

3. European economy posted only moderate recovery due to higher crude oil prices and a stronger Euro.

- The Euro area economy posted only moderate recovery in 2004, as external demand—which led the economy upward in the first half of the year—slackened in the second half due to higher crude oil prices and a stronger Euro.
- The variance in economic performance has become clearer within the euro area, with the U.K., France, and Spain posting high growth on the strength of brisk domestic demand, and Germany and Italy posting slow growth due to sluggish domestic demand.
- The economic recovery in 2005 is also expected to be moderate.

4. Risks to the world economy in 2005

- Among the risks expected in the world economy in the months ahead are an abrupt slowdown of the U.S. and Chinese economies, hovering of crude oil prices at a high level, high level of U.S. current account deficits, and wild exchange fluctuations of the yuan.

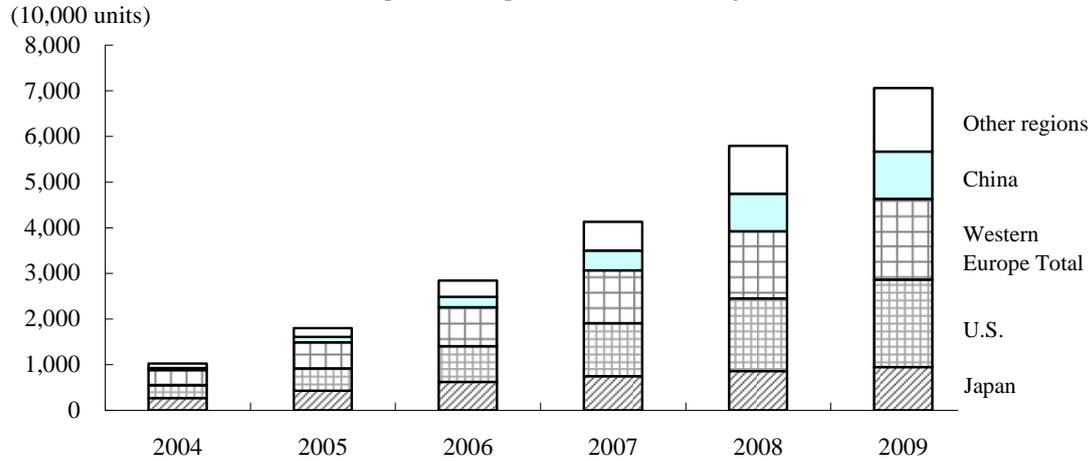
Part 2 Key Points of Chapter 2

1. IT market in continued adjustment phase and The Demand Trends in the U.S.

- **The global IT market, which entered an adjustment phase in the second half of 2004, has been in an adjustment phase as of the first half of 2005.**
- **But, the extent of adjustment has been minimal, reflecting a cautious stance toward inventory buildup at the time of business expansion and steady IT-related demand.**
- **Among the factors behind the steady IT-related demand are: the attractiveness of making IT investment to improve efficiency remains strong, and that new demand has been created following a decline in the prices of IT-related products.**
- **Steady IT-related spending is expected against a background of falling prices of IT-related products.**
- **Incidentally, demand for flat-screen TVs in the U.S. was not as strong as in Japan. But, following price declines, interest in the products has increased in the country, raising expectations that the U.S., along with the Chinese market, will become a growth market for flat-screen TVs in the future(Figure8).**

Figure 8 Demand Projections for Flat-Screen TVs (LCD + DPD)

- The U.S. market is expected to expand in the future along with the Chinese market -



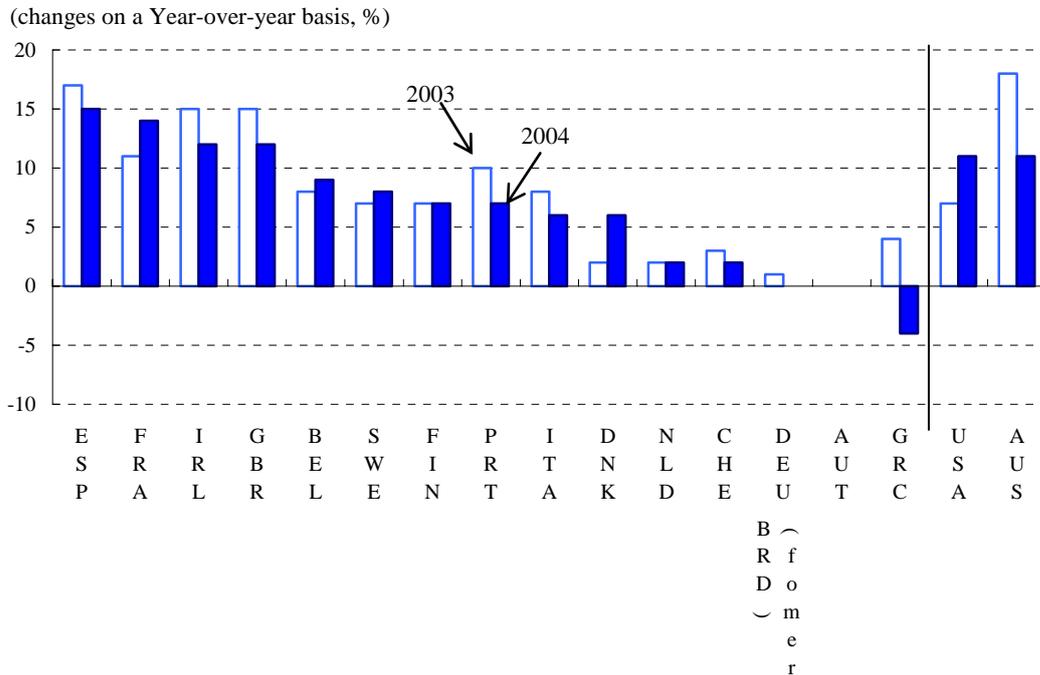
(Note)

1. "Forecast of Demand for Major AV Products" (February 2005), the Japan Electronics and Information Technology Industries Association
2. West Europe Total: 15 EU countries plus Norway
3. Other regions: Total of countries and regions excluding Japan, U.S., West Europe, and China from the 51 countries and regions covered by the forecasts.

2. Housing boom in Europe

● In The Euro area, housing prices has began to rise since the second half of the 1990s. In some countries, housing prices may have been too much overvalued with respect to their economic fundamentals(Figure 9).

Figure 9 House Price Inflation Rates



(Source) U.K. RICS (Royal Institution of Chartered Surveyors)

- The recent housing boom are largely due to low interest rates, financial deregulation, and intensifying competition among financial institutions has helped a decline in housing loan interest rates.
- Another factor is the mismatch between supply and demand, reflecting the fact that while housing demand remains strong due to an inflow of immigrants, the rental market remains undeveloped.
- With housing markets in Europe being expected to remain brisk in 2005, there are concerns that housing prices rise sharp in some European countries. However, the U.K. housing market has been subdued.
- An abrupt adjustment of the housing market might have adverse impacts on consumption through negative wealth effects. However, the risk of a sudden slowdown in housing market should be so far.
- This is because housing demand is expected to remain sound, reflecting the trend of moderate recovery in the Euro area

economy and relatively low level in real estate loans

“World Economic Trend” is a biannual report published by the Cabinet Office of the Japanese government. Developments of overseas economies and economic policies are surveyed from the view point of improving macroeconomic policy management of the Japanese economy.

(The original Japanese version is available at <http://www5.cao.go.jp/keizai3/whitepaper.html#sekai>)