

Chinese economic juggernaut is gaining on Japan

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The lights of Tokyo, where some are asking whether Japan is destined to be the next Switzerland: rich and comfortable, but of little global import.

For years, Japan has been readying itself for the day that it is eclipsed economically by China. But as a result of the global slowdown, Japan's difficulty in managing its economy and China's rise — on vivid display Thursday as Beijing celebrated the 60th anniversary of the founding of the People's Republic — that day may come sooner than anyone predicted.

Though recent wild currency swings could delay the reckoning, many economists expect Japan to cede its rank as the world's second-largest economy sometime next year, as much as five years earlier than previously forecast.

At stake are more than regional bragging rights: the reversal of fortune will bring an end to a global economic order that has prevailed for 40 years, with ramifications across arenas from trade and diplomacy to, potentially, military power.

China's rise could accelerate Japan's economic decline as it captures Japanese export markets, and as Japan's crushing national debt increases and its aging population grows less and less productive — producing a downward spiral.

"It's beyond my imagination how far Japan will fall in the world economy in 10, 20 years," said Hideo Kumano, economist at the Dai-Ichi Life Research Institute in Tokyo.

Not long ago, Japan was "the economic miracle," an ascendant juggernaut on its way to rivaling the United States, which has the biggest economy.

Now, many here ask whether Japan is destined to be the next Switzerland: rich and comfortable, but of little global import, largely ignored by the rest of the world.

Yet even this widely held hope among the country's 127 million people may be slipping from Japan's grasp.

The per-capita gross domestic product of Japan, which surged past that of the United States in the late 1980s, stalled at \$34,300 in 2007; it is now a quarter below American levels and 19th in the world. Both income inequality and poverty are on the rise.

Unemployment stands at a record high of 5.7 percent, while prices and wages are falling fast. Japan's economy shrank at an annualized rate of 11.7 percent in the first three months of the year before recovering to a modest 2.3 percent annual rate of growth in the second quarter.

The Chinese economy is likely to expand 8 percent in 2009, while economists expect the Japanese economy to shrink 3 percent for the year before returning to anemic growth of about 1 percent next year.

The Chinese economy grew about 10 percent a year for most of the last two decades. Over that period, Japan stagnated as huge public works projects aimed at reviving the economy went toward protecting moribund industries instead of fostering new ones, failing to lift Japan out of its doldrums while creating a huge debt burden.

The troubles in Japan have been confounded by its worst recession in postwar history, brought on by the financial crisis that swept across the globe. As demand evaporated in important overseas markets, production and exports slumped as much as 40 percent this year.

Even Japan Inc. is increasingly falling off the global map. In 1988, Nomura Securities issued a ranking of companies by market capitalization, and 8 of the top 10 were in Japan, topped by Nippon Telegraph & Telephone.

As of July 31 this year, not a single Japanese company made the global top 10.

The list was dominated by companies based in China and the United States; Toyota Motor ranked No. 22, at \$144.5 billion, and only five other Japanese companies made the top 100.

The richest man in Japan, the retailing entrepreneur Tadashi Yanai, was 76th in the most recent global Forbes list, behind moguls from countries like Mexico, India and the Czech Republic — a far cry from the late 1980s, when Japanese industrialists like the railroad tycoon Yoshiaki Tsutsumi were among those at the top.

China has also surpassed Japan in having the biggest trade surplus and foreign currency reserves, as well as the highest steel production. And next year, China could overtake Japan as the largest automobile producer.

A new government has vowed to take Japan on a new development path, one that relies less on the exports that have long driven growth and is more focused on increasing domestic demand. The Democratic Party, which recently swept the long-ruling Liberal Democrats out of power, has promised to strengthen social welfare and redistribute wealth more evenly.

Per-capita income in China is still less than a tenth that in Japan. But by other measures, the Chinese economy long ago overtook that of Japan.

In terms of overall purchasing power, China surpassed Japan in 1992 and will overtake the United States before 2020.

In some ways, this reflects economic fundamentals: As countries develop, growth tends to slow. Annual growth in Japanese gross domestic product averaged 10.4 percent in the 1960s and 5 percent in the 1970s, but only 4 percent in the 1980s and 1.8 percent in the 1990s, according to Goldman Sachs. In the first decade of this century, growth has been even slower.

Some economists say Japan does not need to fear its neighbor. China became Japan's largest trading partner in 2006, and China-bound exports were among the first to show signs of recovery in the recent slump. As the global auto market stagnates, carmakers like Toyota and Nissan are making a renewed play for the Chinese market.

"Japan is neighbors with a rapidly growing market," said Nobuo Iizuka, chief economist at the Japan Center for Economic Research. "That is a great advantage, not a threat. The question is, can Japan build on that advantage?"

Still, said C. H. Kwan, a senior fellow at the Nomura Institute of Capital Market Research, based in Tokyo, "this is a big psychological shock to Japan."

Mr. Kwan, a native of Hong Kong, migrated to Tokyo after being awed by the 1979 book "Japan as No. 1," by Ezra F. Vogel, who sang the praises of the country's fast economic growth.

Now, he is working on a book of his own: "China as No. 1."

Based on current growth and currency trends, Mr. Kwan forecasts that the Chinese economy could surpass that of the United States in 2039. And that date could move up to 2026 if China lets its currency appreciate by a mere 2 percent a year.

"We're no longer talking about China making lots of shoes," he said. "China is about to leave everyone behind in a big way."

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