

EMERGENCE OF THE CHINESE ECONOMY AND IMPLICATIONS FOR KOREA

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Recently, Korean companies have begun to view China in a new light due to its selection for the 2008 Olympic Games and its expected entry into the WTO in November. These two events have raised hopes that China will be a promising country for investment.

Current status of China's economy

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China has enjoyed an average annual growth rate of 9.6% since it adopted the "internal reform, external opening" policy in 1978. Even during the Asian financial crisis, China's growth rate stood at 7% to 8%. In 1999, China's GDP recorded 989 billion dollars, which was more than twice that of Korea and seventh in the world after the US, Japan, Germany, Britain, France, and Italy.

China's economy has relatively low export dependence and has seen continued growth based on its huge domestic market. Structurally, the Chinese economy is relatively unaffected by external changes. If one examines the contribution to the country's economic growth in 2000, consumption, investment, and exports accounted for 3.8%, 2.6%, and 0.7% respectively, showing that domestic demand is the main impetus for economic growth.

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With continued economic uncertainty in Southeast Asian countries, the relative stability and high growth potential of China is attracting an increasing amount of foreign direct investment. China's low wages, vast domestic market, and institutional improvement and regulatory reform due to WTO entry are bringing an investment rush by foreign companies vying for the country's domestic market and global production base. In addition, China is shifting the focus of its industrial structure from labor-intensive industries to high-tech industries such as semiconductors and mobile telecommunication.

New foundation for China's economic growth: the Olympics and WTO

The Chinese economy, which maintained high growth rates for the last two decades, is expected to achieve even faster growth with the coming Beijing Olympics

and entry into the WTO.

The Beijing Olympics will have several economic effects. First, economic growth will be accelerated. Second, higher national credibility will help increase foreign direct investment. Third, the industries associated with infrastructure investment for the Olympics will get a boost. 280 billion yuan (about 35 billion dollars) will be allotted to creating infrastructure for the Olympics, and this is expected to stimulate the construction, real estate, environmental, tourism, and service sectors.

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China's entry into the WTO will also have a number of effects. First, the country's industrial structure will be modernized due to market opening. Second, national policy, improved corporate transparency, and higher credibility are expected to expand foreign direct investment. Third, exports are forecast to expand, along with modernization of export structure.

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As a result of the two events, China's economy is expected to grow at 7 to 8% over the next decade.

Table 1. Growth Forecast for Chinese Economy

	(Unit: %)	
	2000-2005	2005-2010
Average Annual GDP Growth	7.8	8.1

Source: Chinese Academy of Social Sciences, WEFA

Challenges and opportunities for Korean companies

One challenge for Korean companies is the increasing competitiveness of Chinese products in the world markets. Based on the rapid growth of its manufacturing industries, China's occupancy of the world market increased rapidly after 1990 to far exceed that of Korea by 1999. China's prominence in the world market is expected to further grow after the country's entry into the WTO, especially in the US and Japan, which are Korea's key markets.

Table 2. International Exports of Korea and China

	(Unit: billion dollars, %)					
	1990	1995	1996	1997	1998	1999
Korea's share of world market	1.9	2.4	2.4	2.5	2.4	2.5
China's share of world market	1.8	2.9	2.8	3.3	3.4	3.6
Korea/China	10.47	8.40	8.58	7.45	7.21	7.36

Source: KOTIS, 『International Financial Statistics Yearbook』 IMF, 1999, 2000.

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Second, competition between the main industries of Korea and China is increasing. Currently, there is not much export overlap between the two economies, as a high share of China's export industries are considered as mature or sunset industries in Korea. However, China is currently trying to shift its export structure towards more technology-intensive categories, and is also actively promoting high-tech industries, which is expected to increase the competition between the main exports of the two countries.

Third, the rapid growth of Chinese companies, especially large ones, is expected to intensify competition with Korean conglomerates in the markets of China and developing countries. During 1996 to 1999, China's 100 largest companies grew at an average rate of 11.7% a year, and have acted as the engine of economic growth. In addition, the 100 largest companies are shifting their industrial focus from primary and traditional manufacturing industries to electrical products, electronics, and information technology.

One opportunity for Korean companies resulting from China's WTO entry is the possibility of increased exports to China due to lower tariff and nontariff barriers. In particular, with the recent shift of China-bound exports to components and raw materials, trade is moving from inter-industry to intra industry trade, and linkages in industrial production are intensifying, which is expected to increase exports.

China's WTO entry is also expected to stimulate institutional reform, which will improve investment conditions and result in business opportunities. With market opening, Korean investment in China is expected to expand from manufacturing to non-manufacturing sectors, and labor-intensive to technology and capital-intensive sectors.

Investment approaches for Korean companies

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Firstly, it would be a good idea for Korean companies to explore investment in China through "active localization". To achieve this, Korean companies need to have an accurate and positive perception of the Chinese market and a willingness to adjust themselves to conditions in China.

Second, Korean companies need to recognize that the Chinese market is very diverse, and create differentiated investment approaches accordingly. Approaches should vary according to a target area's industry characteristics, purchasing power and consumption tendencies, and technology levels. Such a strategy would help reduce trial and error.

Korean firms should actively explore joint ownership and partnership strategies.

Finally, Korean companies should aim for "domestic marketization" of the Chinese economy based on technology. Because the Chinese market is targeted by the world's leading companies, Korean firms should actively explore joint ownership and partnership strategies to gain an edge over the competition. **VIP**