Chinese Bubble Economy Will Burst Soon.

Excessive dependence on China will cause the crisis in Japan.

Not only Japan but the whole world increasingly depends on China. How is this risky?
If the Chinese economic bubble bursts, its effect will be much greater than the burst of Japan's economic bubble. What's more, it is expected to happen soon.

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The Japanese economy will be exposed to the biggest risk since WWII from 2005 to 2010. The domestic economy will rapidly decline because of the aging population and the diminishing number of children combined with a fiscal crisis, and the Chinese economic bubble will burst soon. Japanese companies already rely on China heavily, considering China to be the "lifeline" of Japan in the 21st century.

However, excessive dependence on China is very risky from the standpoint of economic security. In addition, as the economies of other advanced countries also rely on China, the burst of the Chinese economic bubble will affect the entire world. If it happens together with the decline of the Japanese domestic economy, Japan will face a crisis of unimaginable proportions. If Japan can overcome this crisis, Japan will recover as one of the leading countries in the world. If not, Japan will decline even further. No one in the world can stop the decline of Japan, a small-sized country with few natural resources and a population of 130 million. Our actions at this critical juncture will affect the lives of future generations.

<u>Japanese companies have no choice but to set up operations in China.</u>

The largest factor is the demographics. In the next 15 years, the elder population will increase by 10 million while the working age population will decrease by 10 million. This will impact the Japanese economy in various ways. The costs of pensions, health insurance, and nursing care are increasing, while skilled young talent is becoming scarce; domestic manufacturing will only become more difficult in Japan. Some say the country should accept immigrants. But when those companies from America, where the number of immigrants is still the world largest, are transferring their operations to China, it shows us that immigrants are not the solution for the decline of Japan's competitive edge.

Another factor that increases the cost of doing business in Japan is the progression of fiscal collapse. The current government presents a tax increase as the solution. The government uses the slogan of "Koizumi Reform" but leaves the problem of inefficient use of tax revenues unsolved.

For example, 10 trillion yen, a quarter of Japan's entire tax revenue, is spent on roads. The road-purpose tax that is collected at tollbooths is not spent on highways but on the construction of general roads. Japanese highways continue to charge highest tolls in the world. The privatization of highway-related public corporations confirms such an untenable situation. The original purpose of privatizing the Post Office was to reform the government investment and loan system. However, the much-publicized privatization of the Post Office never touches upon it. Currently, the Ministry of Finance borrows 360 trillion yen from postal savings, postal life insurance, and pension funds and lends it to government-affiliated public corporations. Since the reform of the system is postponed, the burden on citizens is increasing. There is contradiction in the interest rate issue. The zero interest rate policy for the last 10 years was presented as the solution for non-performing loans. It seriously affects asset management of pension funds that originally targeted to gain 5.5% growth per year. On the other hand, if the interest rate is raised, the interest payment on government bonds, which amounts to 700 trillion yen, also increases. This just adds to the decline of Japan's fiscal health.

Japan has never solved the problem of depopulation in rural areas and congestion in urban areas. Over 82 million people, more than 60% of Japanese population, live on 3% of the land. Therefore, the cost of doing business remains high. The US promoted regional dispersion for the past 30 years to recover its competitive edge. For example, only 7 of the 30 companies that make up the Dow Jones Industrial Average are headquartered in Manhattan, New York. In Japan, about 70% of the companies newly listed on the Tokyo Stock Exchange are headquartered in Tokyo. As the business environment in rural areas is not conducive to running an affordable and efficient operation, companies relocate to China rather than the rural areas of Japan.

Twin deficits caused by excessive dependence on China

The advance of Japanese industry in China is accelerating. This exists in many forms; the simple export of Japanese products to China, the production of Japanese goods in China and their re-import to Japan, and in full-scale business from production to sales in China. As a whole, this shift is continuing because companies have profited from it. As Ms. Kathy Matsui at Goldman Sachs pointed out, earnings of companies that have moved their operations to China have significantly improved and their stock prices reflect their success, outperforming those in the Nikkei Average Index by 100%. Industries that were structurally depressed formerly, such as iron and steel, marine transportation, shipbuilding, and chemistry, are now quite profitable.

More importantly, Japan's leading companies, including automobile and electronic companies, have already started to construct some of the largest factories in China. They see China not only as the place to products for re-import into Japan and export to America and Europe, but also as a vast, untapped consumer market. Therefore, they transfer their operations from Japan to China. When this transfer is complete, the Japanese economy will change drastically. Chinese exports to Japan will increase. Additionally, Chinese exports to the rest of the world will increase at the expense of Japanese products; exports from Japan to the rest of the world will decrease. Through this process, Japan's balance of payments will deteriorate.

Within Japan, the reduction of the number of those of working age will lead to an increase in the retirement age. Overall, employment will still decrease, so income and savings will decrease. As a result, consumers will become more price-sensitive and inexpensive products made in China will become more attractive to them. Japanese consumers will have less resistance toward those products because they are made by Japanese companies in China. In the end, Japan will become a net-import nation instead of a net-export nation. With the rapid aging population and extremely low birthrate, the balance of payments will fall into deficit and Japan will have the so-called twin deficits, a trade deficit and a budget deficit. Since domestic savings are decreasing, Japan must raise funds from overseas. Without help from overseas, Japan cannot absorb government bonds to cover its deficits and formulate a budget. If the current economic system continues, interest rates and the prices of imports will jump and the stock market and real estate values will tumble. Japan's excessive dependence on China contains such a risk.

Blind side of developing China

Before we worry about the twin deficits of Japan, we should consider whether China will continue to grow or not. America and Europe view continued growth in China as ideal. Some reports show that China's GDP will reach that of Japan in 2015 and reach that of the US in 2040, becoming the largest GDP in the world.

In the last 10 years, world economies have come to rely more and more on China. Economic growth is slowing in other major countries due to the aging population/low birthrates as well. The added costs of caring for retirees has a direct impact on the corporate bottom line. Since the 1990s, the structure of world economy has been changed by the entry of China with its population of 1.3 billion. China has an abundance of trainable and already well-trained workers and vast land and natural resources, so its production costs are significantly lower. The rise of China as giant consumer market is the world's "winning formula." Companies in major countries lower their production costs by transferring their operations to China and increase their profits by selling to Chinese consumers. As a result, stock prices of major international conglomerates rise, asset income and consumption are increased and jobs are created, further supporting the economies of major countries.

Especially in the US, imports from China are increasing sharply and the trade deficit is worsening. Most of these imports are products made in China by American companies, which are recording record profits due to the lower production costs in China. This accelerates the advance of American companies to China and further enlarges the trade deficit. The fixed rate of the yuan to the US dollar also accelerates such movement. If the US dollar depreciates, the yuan also depreciates. Chinese products remain price competitive and American manufacturers' profits are assured. This development is promoted and capital, technology and factory equipment roll into China, creating jobs for Chinese workers. On the surface, the existence and prosperity of American companies and the Chinese economy appear to be intertwined. This is an example of the "winning formula," the theory that the rise of China supports global economic growth.

However, a look at the reality of the Chinese economy shows that this formula contains huge risks and the world economy faces a possibility of a meltdown stemming from China's heady growth. Its impact will be much larger than that of Asian currency crisis in the 1990s.

Deep roots of the Chinese bubble economy

The most serious problem in the Chinese economy is the expansion of non-performing loans. More than 80% of all of the loans in China have been extended by state-owned banks and 60% of them have been extended by the 4 largest state-owned commercial banks. There are few private banks and the securities market is under-developed. The government has a monopoly on the financial market. Of the loans made by the four largest state-owned commercial banks, 70% were made to state-owned corporations and 40% of them appear to be non-performing. In all, about 30% of all of the loans made by state-owned banks are in default. In addition, the amount of outstanding loans in developing countries is unusually huge; it may reach 1.5 times of GDP (150 trillion yen). The amount of non-performing loans may reach the half of the GDP. The roots of this problem are deep and exacerbate the various problems China is facing.

State-owned corporations dominate in employment and distribution of capital and resources in China. However, they still must obtain approval from the government for investments and important management decisions. Although China has introduced a market economy, politics are extremely important. In state-owned corporations, top Chinese Communist Party officials reign over management. In many cases, they make decisions based on political considerations and private interests rather than sound fiscal management considerations such as profit-making and debt repayment. As state-owned corporations have excessive numbers of affiliates, there is excessive competition in most fields. State-owned banks routinely extend additional loans to cover their losses but many still end up in bankruptcy.

The state-owned banks couldn't cover such non-performing loans so the government issued bonds worth 5 trillion yen to cover the losses last year. This is just "*tobashi*," shuffling banks' investment losses. The budget deficit is also expanding and the number of government bonds being issued is increasing. The privatization and listing of state-owned corporations are considered to be a panacea for their revival. However, this is no solution.

There are some state-owned corporations, such as Haier, which is growing due to privatization. But in most state-owned corporations, only profitable divisions are privatized and listed separately from other divisions that hide their losses. Often the capital raised by investors is used to cover the loss and then is shared among high officials. General investors are left holding the bag and stock prices go down. Because many want to invest in China, capital is easy to be raised. Corporate corruption is serious. Breach of duty, embezzlement, and diversions of employees' pension funds are daily occurrences. Even after privatization, there is no corporate governance in many corporations. Chinese domestic securities markets, other than Hong Kong, allow activities equivalent to money-laundering. Therefore, the policy to privatize state-owned corporations and to reduce the non-performing loans has been a failure.

The Chinese stock market, which consists of privatized companies, reflects such conditions sternly. In a healthy capitalist economy, the stock market percentage gain exceeds the economic growth rate significantly in a high economic growth period. In Japan's high economic growth period (from 1966 to 1975), the average economic growth rate was 6.7% per year while the stock index jumped 220% and average growth rate was 11.6% per year. In Korea and Taiwan (from 1981 to 1990), the economic growth rates were 13.8% and 12.8% respectively while their stock indexes rose 18.2% and 23.5% per year respectively. However, China attained a high economic growth rate of 9.5% per year while the Chinese representative stock index, the Shanghai Stock Exchange A-share Index, was down 7.6% the past year. It has fallen about 40% since it peaked in June 2001. The Shanghai Stock Exchange B-share Index for foreign investors fell to one-third of the peak (June 2001).

This shows that Chinese capital productivity both in loan value and stock value is remarkably low. The fuel efficiency numbers reveal that the productivity of resources is also significantly low in China. It is contrary to the conditions in Japan and Korea, which both attained high economic growth through the high productivity of capital and resources in addition to low wages.

While non-performing loans in state-owned corporations and banks are expanding, foreign corporations are increasing their market share and their profits in China. American, European, and other Asian countries with capital, technology and brand power are expanding their production and hiring workers. They are boosting Chinese GDP. Most corporations are re-investing their profits to expand business. As strong foreign corporations succeed in China, inefficient state-owned corporations are forced into bankruptcy. However, China cannot stop foreign corporations from coming into China because they are supporting Chinese economic growth and bringing in capital.

Though mostly confined to large cities, there is a real estate bubble too. The construction rush started with the inflow of foreign capital. China's fixed asset investment at the beginning of 2004 increased more than 50% over the previous year. Outstanding of loans in financial institutions is also increasing. The increase in real estate prices significantly exceeds the pace of salary growth. The average price of a residence in Shanghai is 22 times the average annual salary. It is beyond the fundamentals. The spiraling real estate prices trigger speculation in the major cities, much like Japan in the 1980s. Yet other cities are mired in poverty.

The agricultural communities, employing 60% of the population, have fallen behind foreign corporation-led and large city-oriented economic growth. Farmers have become poorer due to a drop in their purchasing power, lower agricultural product prices, and a heavy tax burden. The infrastructure is not organized from the viewpoint of both hard and software. Additionally, as Chinese Communist Party executive officials often extend loans at high interest rates and hold land as collateral, unemployed farmers are forced to migrate to the cities in search of work.

As a result, there is sufficient evidence that the China bubble is going to burst. For example, consider this evidence: the lack of morals both in financial institutions and corporations which make excessive investments and loans, unfeasible business plans, the expectation and greed for economic growth which supports such plans, failure of government and the market to oversee an orderly economy, and insufficient information disclosure. In addition, since the government is deeply involved in creating the bubble economy in a manner that is never observed in capitalist countries and the disparity and inequality in society have become substantial, the problem is more severe. If the so-called bicycle, the foreign capital inflow, stops, the Chinese economy will falter and the repercussions will be worldwide.

<u>It is the eve of Chinese shock for the world.</u>

Many people say the Chinese economy will never go bankrupt. Their rationale is that China has 500 billion US dollars in foreign currency reserves, the second largest reserves in the world after Japan. However, the base for this large amount of foreign currency reserves is fragile. In the case of Japan, resources for the foreign currency reserves are a trade surplus of 11 trillion yen, which was raised by the exports of Japanese corporations.

The Chinese trade surplus is 3 trillion yen (30.4 billion dollars) and much smaller than that of Japan. Capital inflow from direct investment by foreign corporations is the main source of huge foreign currency reserves in China. Fixed asset investment by foreign corporations in China is made in yuan that has been converted from foreign currencies. Moreover, the products made in China by such corporations are sold outside of China in foreign currencies. Under strict currency control in China, foreign corporations receive yuan instead of foreign currencies and the foreign currency reserves have become immense. If the capital inflow from foreign corporations stops and they convert the yuan in hand into foreign currencies, the foreign currency reserves in China will be sharply reduced. Chinese foreign currency reserves depend on foreign corporations.

China's finances are in a critical situation. If China disposes of the bad debts it is holding, the serious problems of unemployment and social structure will affect mainly the cities. As previously mentioned, agricultural villages are emptying as farmers face a food shortage and head to the cities to find work. With no work available, and no facilities to receive these work seekers, public unrest may occur. In order to prevent such unrest, China must solve its non-performing loans and problem of pension funds in a responsible manner. It is estimated that the burden will be equal to the GDP. This far exceeds its foreign currency reserves. Yet no action is being taken. These non-performing loans and the latent budget deficit are both swelling.

It is true that Japan's accumulated budget deficit exceeds its GDP, but Japan's citizens have vast savings and many corporations operate on a global level. The Chinese domestic economy has no power to grow to cover its budget deficit if foreign corporations withdraw from China. If China forces foreign corporations to bear more burdens to cover its budget deficit, capital inflow from foreign countries will stop, foreign currency reserves will drop sharply, and the Chinese economy will fail. The value of the yuan will collapse and foreign corporations in China would suffer. As companies begin to withdraw from China, the entire economy will suffer. This is a dilemma. Although China must act, it cannot do this on its own. If something happens, it may trigger an economic crisis directly.

A currency issue may also trigger the crisis. Currently, the yuan is fixed to the US dollar at relatively undervalued level. Therefore, production in China and re-import to the US is highly profitable for American corporations. This is also favorable for Chinese employees of American corporations.

On the other hand, in the US, there is criticism that "outsourcing" to China deprives Americans of jobs. Additionally, only after 4 years of the Bush administration, America has a serious budget deficit. The confidence in the dollar has been shaken and further dollar depreciation against the euro and yen is expected. If the Chinese yuan is fixed to the dollar, which is supposed to be stronger when the yuan is not pegged to the dollar, adjusting the trade deficit by allowing the dollar to depreciate would never work. Therefore, the pressure on the dollar pushes the euro and yen up excessively. In order to correct such an imbalance, the pressure to re-value the yuan or move to a floating rate system will increase.

If China is forced to introduce a floating rate system after the yuan appreciates, like the yen did, the risks of the Chinese economy will increase. Under a floating rate system, a currency fluctuates. The yen has fluctuated between 80 and 360 yen to the dollar in the last 30 years. If the yuan appreciates sharply against the dollar and production in China is not profitable for American corporations, capital inflow into China will stop. "A depression caused by yuan appreciation" would occur. Economic growth will stop, the problem of non-performing loans will be unmanageable, the risk of holding yuan will rise, and then the yuan will start to depreciate sharply. Foreign corporations will sell yuan and it will accelerate yuan's depreciation.

Of course, the Chinese authorities are aware of such risks and strongly object to making the transition to a floating rate system. From Japan's experience, once China agrees to yuan appreciation, further appreciation is requested and eventually it is forced to introduce a floating rate system. If it happens, the scenario that a currency crisis triggers an economic crisis becomes more likely.

The current global economic condition is just like that of the first oil shock period in the first half of 1970s; it approaches a large crisis. Common issues at that time were: a continuing tension in the Middle East, a prolonged war waged by the US, the deteriorating fiscal health of the US, the rise of emerging countries (Japan and Germany at that time and China today), the deteriorating trade deficits of the US, pressure to appreciate currencies fixed to the dollar (yen and mark at that time and yuan today); a shortage of resources, and a rise of prices of oil and primary products. When America and European countries realize that the Chinese economy is controlled by the political interest of the bureaucrats and inefficient as the one during the Tiananmen Square incident, and that their capital supports the Chinese bubble but the issue of the non-performing loans cannot be solved by China itself, the risk increases. Because those companies will begin to withdraw capital from China.

After the oil shock in the 1970s, the imbalance of the global economy became apparent, the floating rate system was introduced, the stock market became sluggish, and pension funds went bankrupt. The global economy suffered catastrophic damage in the form of depression and inflation (stagflation) for 10 years. Japan was the first country to recover from the oil shock. The finances of the US and the UK collapsed leading to Reaganomics and a revolution by Thatcher in the 1980s. Compared with that time, the world's economy is remarkably interdependent. Accordingly, the collapse of the Chinese economy will deal the global economy a major blow. Since optimism about China is high in Europe and America, though awareness of the realities is low, the risk is high. A structure to provide worldwide risk management and policy cooperation will be essential.

Line of defense by Japanese corporations

In Japan, the above-mentioned structural risk in China and its effect on the global economy are not recognized. The transfer of operations to China by Japanese corporations is accelerated as "it is safe to run a red light, if you are all together." The situation resembles the one in which all of Japan was happy inside the bubble economy. When the burst of the Chinese bubble economy involves many Japanese corporations, it will cause devastating damage to Japan. Japan will go into a decline because of the aforementioned demographics and the ensuing financial collapse.

Nonetheless, Japanese corporations cannot withdraw from China completely. It is necessary for them to transfer their operations to China because Japan will face a severe shortage of workers in the future due to the declining birthrate. Since the idea of accepting a lot of immigrants is not realistic, transferring operations to China is the most realistic way to cover the shortage of workers.

Based on such a reality, Japanese corporations should focus on production and export without depending on the Chinese domestic economy excessively until the problem of non-performing loans in China is solved. Before investing and selling in China, they must plan carefully to reduce risk. Especially in dealing with state-owned corporations, Japanese corporations need to proceed cautiously. They should realize that the assumption that state-owned corporations will be saved by the government cannot be made when the problem of bad debts becomes serious enough. Even if China can prevent economic failure, related parties must cover their losses to solve the problem of non-performing loans. Foreign corporations that are involved may be made to shoulder the burden.

The failure of Guangdong International Trust and Investment Corporation (GITIC) in 1998 is a good example. Many foreign investors, including Japanese banks, lost heavily but Chinese government did not take responsibility for the failure. Over 100 billion yen of capital was lost. Li Changchun, who was in charge, was promoted to the 8th most powerful position in the Chinese Communist Party. This shows that even if foreign corporations suffer losses caused by non-performing loans in China, there is no bail-out plan for them. To begin with, the current problem of non-performing loans in China is too large. A bail-out plan will be impossible.

Japanese corporations must protect themselves. Based on their experience in the burst of the Japanese bubble, they should investigate opportunities thoroughly and control risk completely in investing in local factories and extending loans to Chinese corporations, and in every step of production, sale and import/export. Especially, as real estate prices are especially frothy, they must be most cautious when purchasing real estate and extending mortgage collateral loans. Basically, they should simply rent, not purchase. They also should shorten their leases and hold their assets in cash and in easily convertible currencies. Once the crisis hits, it will be too late to dispose of assets in China.

From "wealthy first theory" to "judgment of right and wrong based on reality"

What will happen to China? To foresee the future of China, it is necessary to study its historical and political background. The Chinese economy suffered huge losses when European and American corporations withdrew from China after the shock of the Tiananmen Square incident in 1989. As a prescription for the damaged economy, Deng Xiaoping initiated reform by opening up to the outside world. The Jiang Zemin administration promoted it. The administration suppressed democratization movements while promoting economic growth and the dream for a wealthy life.

One of the measures was to attract foreign capital to special economic zones. This measure was successful and jump-started economic growth. Deng Xiaoping suggested "wealthy first" by encouraging people and areas to be rich and ignoring the expanding gap between the rich and the poor. He made light of redistribution of income to poor areas and low-income people and the organization of infrastructure. It was obvious that this measure conflicted with the basic idea of Communism, "an equal society." In fact, the gap between the rich and the poor with respect to income widens quickly and farmers, who comprise 60% of the population, grow poorer. Many city-dwellers are also in danger of poverty and live in uncertainty. They do not have pension funds, health insurance, or unemployment insurance and worry seriously about their future. Yet fortunes made through fraudulence by officials increased dramatically. The citizens rage against the authorities and rich entrepreneurs that have forced citizens off of their land so it can be developed.

When China began to open up to the outside world, the prestige and legitimacy of the Chinese Communist Party declined dramatically. Citizens protested but were suppressed. The Falun Gong, a religious movement with over 100 million followers who participated in local uprisings, were thoroughly repressed while corrupt officials were prosecuted. For four years between 1998 and 2001, 60,000 death sentences were executed. Under these circumstances, the anti-Japan campaign, waged by the Jiang Zemin administration since 1995, emphasized the role of Communist Party in the war to release people from the control of Japan. The purpose of this campaign was to recover the legitimacy of the Party and to distract people from complaining about their daily life.

Highly experienced officials, such as Hu Jintao (Chinese President) and Wen Jiabao (Prime Minister) are well aware of the seriousness of the bad debt problem, the necessity for the reform of state-owned corporations and banks, the importance of foreign corporations to the Chinese economy, and the importance of corporate governance through overseas markets. They understand the limit of the control by power under the Jiang Zemin administration and, as stated in the latter half of the "wealthy first" theory by Deng Xiaoping, they try to share the wealth. They are correcting the gap between farm villages and cities, and coastal areas and inland areas. They are reducing the tax burden of exploited farmers while they try to organize social welfare for the people in cities such as unemployment insurance, pension funds, and insurance for handicapped persons. They are very interested in environmental issues. They recognize how much the Chinese economy depends on foreign capital and try to maintain sustainable growth by favorably weaving the Chinese economy into the world economy to preventing unnecessary battles with major countries. To reform state-owned corporations and banks, the Chinese government plans to list them on foreign securities markets such as the New York Stock Exchange, to abolish the moral hazards of management by political intervention and to establish governance.

Such attitudes under the new administration can reduce the uncertainty that major countries feel about the future of China. However, the bubble economy is expanding after the administration of Jiang Zemin. The power base of Hu Jintao and Wen Jiabao is still fragile and the conservative privileged class of local Communist Party members has strong power to protect their vested interests. Moreover, the measures to correct these gaps and organize social welfare will be costly. It is doubtful that such measures, which require people to share the burden, will be effective in a society that is based on personal interest. For example, to correct the gap among areas, an income transfer from rich areas to poor areas is necessary. This is similar to the local distribution tax in Japan. But due to the strong objection of rich areas, such income transfer never happens. If conservative people strongly object, the risk is that people's frustration will grow. Therefore, it is important for major developed countries to support the new administration.

Normalized relations between Japan and China ceased in 2001 because Prime Minister Koizumi accepted Jiang Zemin's challenge to a quarrel; the issue of Prime Minister visit to Yasukuni Shrine. Japan cannot win the new administration over to its side. Mutual distrust and animosity in both countries exist. In 2005, China will commemorate the 60th anniversary of the war between Japan and China and the tension between the two countries will be heightened by historical issues. Even under the new administration, to release China from Japan's control is a chance to recover the legitimacy of the Communist Party as its ideal to realize equal society is unattainable. Therefore, the scale of this movement will be large. The anti-Japan movement may be a shield for an anti-administration movement. It may lead to the deterioration of public sentiment in both countries, and to the boycott of foreign (including Japanese) goods/capital. Instability in China will result.

Japan should make the new administration in China realize the risks of the conflict between Japan and China. Both should set aside historical issues and solve the problem from a long-term view point. Additionally, Japan should force China to solve the urgent problem of non-performing loans and to establish an international structure. Moreover, regarding China's invasion of Japanese territorial waters, Japan should notify China of Japan's rights with the help of the US and the United Nations.

What Japan must do today is to cooperate with major countries, especially the US, which have in common the need to head off a China-led crisis. Japan should force China to restore its economic and financial systems, to separate politics from economics, to allow foreign reserves in various currencies, and to disclose necessary information. In other words, China should be under international control and be incorporated into the global economic structure, especially in terms of currency, finance, and investment. Hu Jintao will try to transform China from a corrupt economic system which prioritizes politics to a development dictatorship system with transparency and efficiency. Such assistance by major countries will support the new administration in China, help Hu Jintao carry out his plan, and ease China into the global economic system.

If the world's new economic order is established, China will also realize the necessity of a peaceful coexistence with Japan. In addition to the current one-way investment from Japan to China, investment from China to Japan, and the steady purchase of Japanese government bonds by China to diversify their foreign currency reserves will be possible. For China, most important issue is to stabilize the value of the yuan and to have constant capital inflow from foreign countries. If Japan helps with the stabilization of the yuan in cooperation with European and American countries, Japan can expect China to be cooperative in realizing the above-mentioned ideas. Furthermore, Japan's environmental technology, such as ecologically-friendly cars, will be essential as China whose society becomes more car-oriented but faces even worse oil shortages. Japan should strategically use the licensing of environmental technology since China invades Japanese territorial waters frequently.

What Japan needs to do is to research of the real Chinese economy carefully. Japan should not take advantage of a boom. Japan should cooperate with other major countries to urge China to move in the right direction. Moreover, Japan should recover its national strength by fundamentally changing its current domestic economic policies with their empty slogan that just weakens its national strength. When Japan can thoroughly judge right from wrong based on reality both nationally and internationally, Japan will reemerge as a world leader.