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Topics *China's shift towards a high added value economy*

China's production of electronic information equipment is number one in the world. However, there are a number of problems, such as the fragility of basic research, and in order to progress towards providing high added value, it will be necessary to re-examine the roles of the market and of government in R&D.

■ World's No. 1 production of electronic information equipment

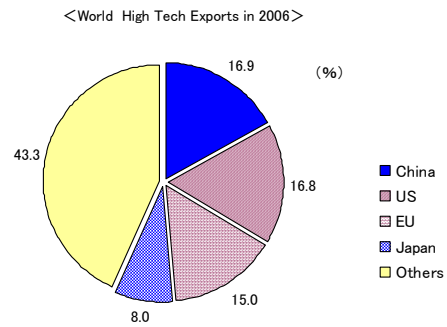
China is shifting towards a high added value economy. The Ministry of Industry and Information Technology (MIIT) put China's production of electronic information equipment in 2009 in the number one position in the world. According to MIIT, China's production of mobile phones was 620 million units, 49.9% of the global share; personal computers, 180 million units, 60.9%, similarly; color televisions, 98.99 million units, 48.3%; and integrated circuits, 28.3 billion units, 12.9%. The move towards high added value is also spreading to exports. According to EU figures, China's share of high tech exports in 2006 outstripped that of the US, EU and Japan to become the world's No. 1.

The motive force that drives the move towards high added value forward is aggressive investment in R&D, and the scale of such investment in China is already larger than that of France and the UK, and what drives investment is local industry. Of R&D expenditure on the part of middle sized and large enterprises in 2008, a mere 4.2% was provided by government funding, with the remaining 94% funded by enterprise. Foreign enterprise accounted for just 27.2% of enterprise funding, with the remaining 72.8% funded by local enterprise. The move towards high added value used to be considered wholly backed by foreign funding, but in recent years the profile of local enterprise has increased rapidly.

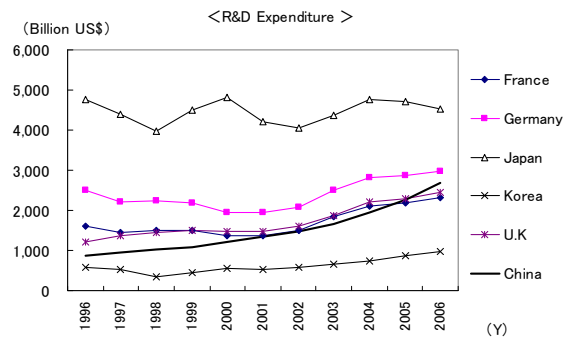
This can also be observed with regard to patents. A breakdown of the international patent applications issued by country, based on the World Intellectual Property Organization's (WIPO) Patent Cooperation Treaty (PCT), reveals that China accounted for 3.7% of the global share in 2008 with 6,089 applications, after the US (32.7%), Japan (17.5%), Germany (11.7%), Korea (4.8%) and France (4.2%). As expected, it is local enterprise that supports the rising position of China in the world. Among the Asian countries only in China is the number of applications by residents (citizens and businesses and groups of the country) the same as or higher than the number of applicants by non-residents (citizens and businesses and groups from other countries)

■ Undermanned basic research

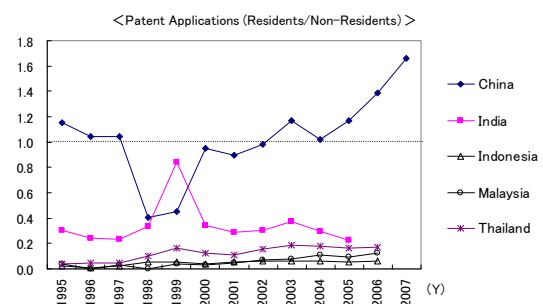
Will China's planned shift towards a high added value economy go according to plan? There are some aspects of China's efforts to develop high added value that are very obviously lacking in balance, and it must be said that there is some concern over future developments. For example, while 75% of China's high tech exports in 2009 were computers and communications related, other items such as



Note: High tech means Aerospace, Computers-office machines, Electronics telecommunications, Pharmacy, Scientific instruments, Electrical machinery, Chemistry, Non-electrical machinery, Armament.
Source: Eurostat

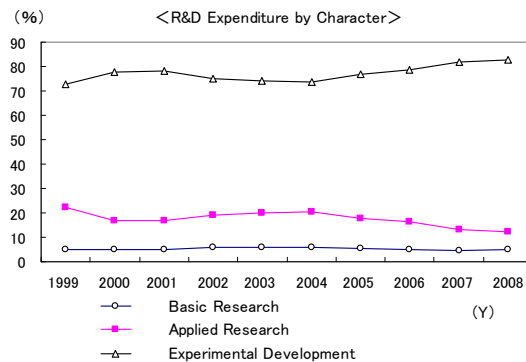


Source: World Bank, *World Development Indicators 2009*



Source: World Bank, *World Development Indicators 2009*

materials, electronic engineering, life sciences, aerospace and biotechnology only accounted for 0.7%, 5.5%, 2.9%, 0.7%, and 0.07%, respectively. And this kind of bias is very evident in R&D also. A breakdown of R&D expenditure shows that experimental development corresponding to improvements accounts for some 82.8% of the total, while basic research and applied research account for only 4.7% and 12.5%, respectively. Basic research among the OECD nations is usually between 15 to 20%, showing that there is a big gap in this respect between China and the industrialized bloc.



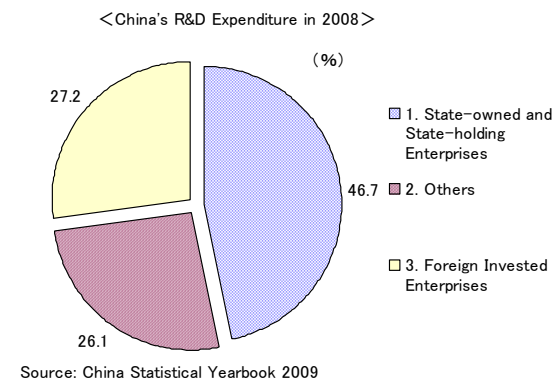
Source: China Statistical Yearbook 2009

China is a developing economy, and it might seem a bit harsh to compare it against the developed economies, but Japan's investment in basic research in 1970 was 28.3%, and China's bias does not reflect the fact that the development stage is low.

Part of the background to this is believed to be the fact that market principles have been introduced into the R&D field and developers are given very strong incentives to expand profits. The introduction of performance based evaluation into public research institutes that are supposed to bear the burden of basic research has resulted in researchers being more oriented towards experimental development. The fact that China's exports of high tech products are so heavily biased towards computers and communications related equipment cannot be said to be entirely unrelated to the fact that R&D in those fields tends to yield short term profit fairly easily.

■ **State run enterprises are the main players in China's R&D**

The planned migration towards a high added value economy involves another issue; the share of R&D expenditure borne by the government and state run enterprises is very high. It was mentioned earlier that a high proportion of China's R&D is accounted for by local enterprises, but an examination of corporate R&D expenditure ownership shows that some 46.7% of that is accounted for by state run enterprises or companies in which the government holds shares. The government share of R&D expenditure among OECD nations is 27.8% on average, so China again has a fairly big gap with the developed countries in this respect.



Source: China Statistical Yearbook 2009

What, then, is the problem with state run enterprises and companies in which the government is a major shareholder accounting for such a high share of R&D expenditure? As far as OECD is concerned, while the influx of foreign capital into China did indeed improve access to foreign technology and know-how, the spill-over effect was not as great as had been expected and, for that reason, concerns have been raised over the questions of the protection of intellectual property rights and corporate governance. With regard to the latter, the concern has been voiced that managers have no incentive for long term innovation and that a government originated top-down approach does not meet the needs of the market.

The over-emphasis of performance-based evaluation in the R&D field and the predominance of state-run enterprises in R&D are hindering the migration towards a high value added economy. If the shift is to be accelerated, it will be necessary to rethink the balance of the roles of market and government.

(Yuji Miura)

Korea Improvements in employment opportunities for the young slow in coming

Overall unemployment rate on the way down

Korea's real GDP growth rate for the period Q1 January to March (compared to the previous period) was 2.1%, 0.2% up on the previous quarter October to December, 2009 (up 8.1% on the same period in the previous year, both figures revised). In recent weeks, both domestic and foreign demand have continued their trend towards recovery.

The unemployment rate (seasonally adjusted) in January rose to 4.8% but increased employment in the private sector and the restarting of the government's temporary employment scheme brought the figure down to 3.2% in April. Though the unemployment situation may be said to be improving, unemployment among the young remains a serious problem and, as of May, the

unemployment rate among the 20 to 24 age group was 7.3%, and the 25 to 29 age group 5.8% (the figures for males were 7.0% and 7.2%, respectively). Specifically, the unemployment rate for the 25 to 29 age group rose from 6.0% in 2006 to 7.1% in 2009. It is pointed out by some that the 'actual unemployment rate', which includes those who do not appear in the unemployment statistics - those who are underemployed, those attending some form of training (employment preparatory schools and universities) in preparation for employment, those studying full time for civil service examinations, and those not actively involved in job-seeking activities - is more than 20%. The Statistics Bureau estimates that the numbers of NEETs (Not in Education, Employment or Training) in the 15 to 34 age range increased from 330,000 in 2004 to 430,000 in 2009.

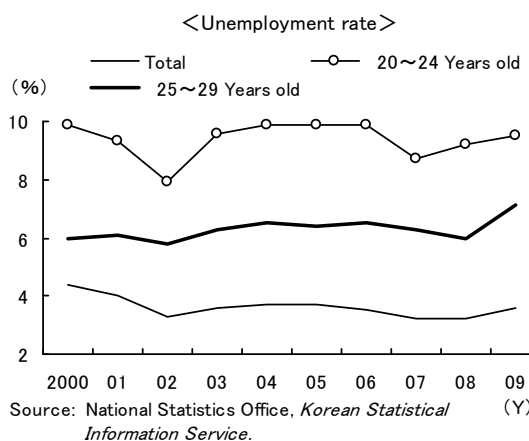
The main factors behind the worsening of unemployment among the young include 1) increased mid-career hiring by companies looking for experienced staff, 2) the slowing of investment growth and its employment creation potential, 3) rapidly increased numbers of young people attending university and 4) the strong desire of university graduates to enter large corporations. In addition to the increased numbers of university places since the 1990s, an increasing trend among young people to attend university in order to win a 'good job', has pushed up the university entrance rate from 33.2% in 1990 to 81.9% in 2009. Moreover, as the employment situation grows tougher, society's 'educational pressure' (from kindergarten, to study abroad) has grown stronger, placing an additional educational burden on family budgets, and is another cause behind the falling birthrate.

Unemployment among the young needs to be resolved over the long term

As Korea attempts to achieve sustainable economic growth, and to effect a recovery in the birth rate, it becomes ever more important to do something to relieve the pressure of unemployment among the young. It is a fact that, as there is little 'decent work' to match young people's education history, more and more graduates of higher education find themselves 'unskilled'. At the same time, small and medium sized businesses are finding it hard to secure staff and are having to look abroad for workers.

One thing that is demanded of the government is that it promote the growth of new industries and businesses through deregulation and investment incentives, and create more 'decent work'. Another is to encourage the flow of highly skilled personnel towards small and medium sized businesses through the expansion of employment training programs and improvements in the small and medium sized business working environment. In doing so, it is expected that, as well as resolving the mismatches in the labor market, the technical expertise of small and medium sized business will also be improved.

(Hidehiko Mukoyama)



Hong Kong Economy maintains recovery theme, though losing momentum.

■ Economy still in recovery mode

Hong Kong's economy has been recovering since early 2009. Real GDP growth in January to March jumped 8.2%, compared to the same period in the previous year (2.4% compared to the previous period). Although domestic demand has lost some of its recovery strength, the recovery was bolstered by foreign demand.

In terms of domestic demand, Private Consumption for January to March, 2010, was a pedestrian 6.5% compared to the same period in the previous year (0.0% growth on the previous period). This has been due to a weakening of the asset effect, against the backdrop of contracting capital inflow and growing concerns over an economic bubble causing share price growth to slow. While Hong Kong's Hang Seng Index grew by 7,379 points from the end of March till the end of September, 2009, growth in the period from the end of September, 2009, till the end of March, 2010, could only manage 284 points. Gross Domestic Fixed Capital Formation increased 10.5% (YoY), due to the waning recovery strength of private sector investment.

As far as foreign demand is concerned, Exports of Goods were up 21.6%, showing strong signs of recovery (up 8.4% on the previous period). Exports to China have maintained their recovery mode. Exports to the US switched to positive year on year growth. Exports of Services were bolstered by a recovery in transit trade and increased numbers of visitors from the Chinese mainland, and grew by 17.9%, similarly (up 6.6% on the previous period).

Reflecting the economic recovery and in response to employment measures, the unemployment rate (seasonally adjusted) fell from 4.9% in October to December, 2009, to 4.4% in January to March, 2010.

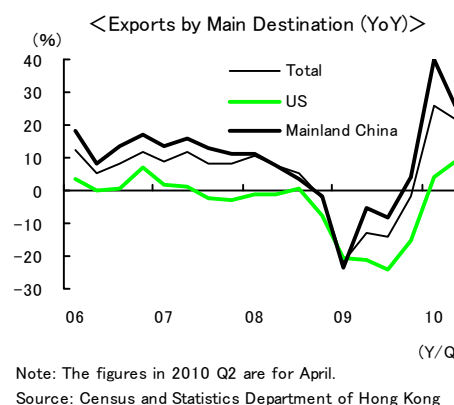
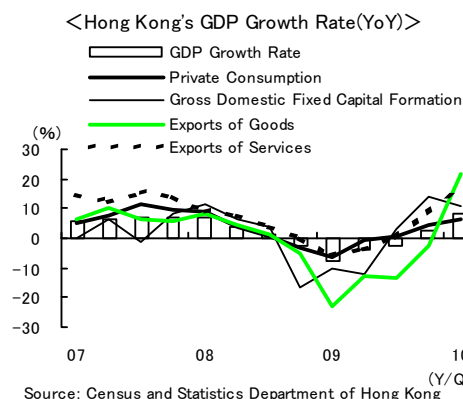
In April, there have been signs that economic recovery strength is beginning to run out of steam. Exports to China grew 25.8%, similarly, in April, which represents something of a contraction from the 40.2% year on year growth posted for January to March. The retail sales growth rate fell from 15.8% in volume in January to March, compared to the same period in the previous year, to 12.4% in April. The unemployment rate stayed steady at 4.4% in February to April, 2010. In terms of individual industries, the rate was practically unchanged in trade related industries, but rose in domestic demand related industries, such as retail, food and drink, accommodation and construction.

■ Foreign demand losing driving power: Internal demand growth also expected to slow

As far as future prospects are concerned, the pace of recovery in foreign demand is expected to decelerate. A growing sense of uncertainty over the future of the European and US economies is likely to lead to a gradual recovery in exports to Europe and the US. Exports for Chinese process trade are expected to begin to see a slowing in forward momentum, as growth in European and US economies will slow. Exports for Chinese domestic demand are thought likely to weaken, given projections that China's economic growth rate may slow. Given the foregoing, Hong Kong's foreign demand will lose some of its driving power.

Domestic demand also looks set to grow at a slower pace. Private Consumption is expected to fail to grow satisfactorily, because of the asset affect and employment situation and salary levels. Gross Domestic Fixed Capital Formation is expected to show little improvement, as transit trade related companies and those in the finance industry experience slower corporate revenue growth and the dissipation of the effect of economic countermeasures.

(Shinichi Seki)



China Beefed up consumption stimulus measures

Reinforcing efforts towards a shift in the economic growth pattern

As China's economic recovery continues, the government's recent economic management emphasizes the following two points. First, there is the enhancement of consumption stimulus measures. From June 1, purchases of automobiles with engine capacities under 1600 cc qualify for a fixed subsidy of 3,000 yuan. Also, the subsidy program for replacement purchases of certain household electrical appliances that was due to finish at the end of May has been extended until the end of 2011, and the number of qualifying provinces, municipalities and autonomous regions has been expanded from 7 to 24.

As regards the reasons behind these measures, there is first of all the attempt to achieve a 20% cut in energy consumption per unit of GDP by 2010 compared with 2005, but the stirring up of consumption demand must also be considered a major goal. In particular, the booster effects of such measures as lower vehicle taxes have begun to weaken, and other factors are causing automobile sales growth to decline gradually, on a year on year basis (figure upper right). The subsidies for low engine capacity vehicles are thought to be an attempt to slow the pace of decline in automobile sales growth.

In addition to subsidies, minimum wage levels are continuing to rise in coastal areas. In 2009 an across the board minimum wage level was unchanged, but the government's stance of implementing of a range of measures designed to spur consumption appears to be strengthening once more.

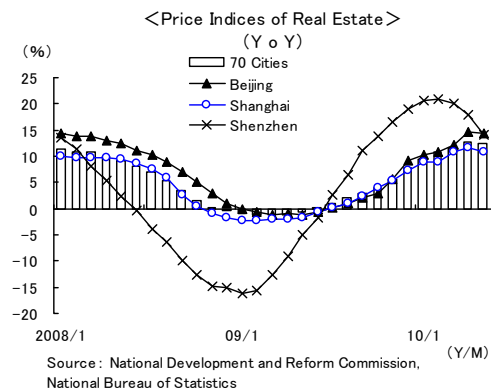
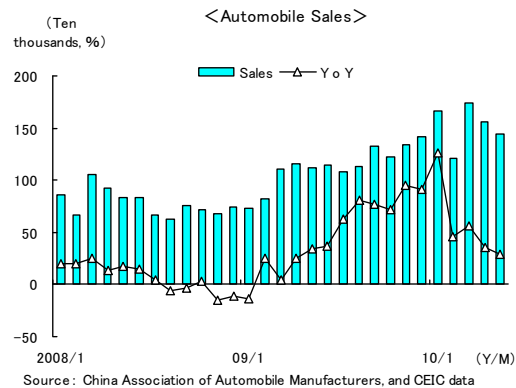
Second, there is the advancement of measures to prevent economic overheating, consisting principally of 1) production capacity adjustment, and 2) a review of real estate related taxation. With regard to the former, in an effort to cut energy consumption and pollutant emissions, numerical reduction targets for each business type were announced in early May. However, in late May the Ministry of Industry and Information Technology decided upon fairly large extra reduction targets for those businesses guilty of over-production (for example, increasing paper production cuts from 530,000 tons to 4,320,000 tons before the end of the year). It is believed that the upward revision of these targets was aimed more at curbing production overheating than the promotion of energy conservation.

With regard to the latter, the Views on Important Issues Pertaining to Economic System Reform announced every year by the National Development and Reform Commission, contained reference to a policy of 'steadily advancing real estate tax reform'. The May real estate price index for 70 cities was 12.4% up on the same month in the previous year, slightly down on April (12.8%, similarly), but still a high figure. For that reason, reforms concentrate on curbing soaring prices and there is a growing view within China that they are suggestive of a review of taxation on real estate ownership.

Multi-faceted approach is vital

These initiatives may be said to be part of an attempt to change the growth model from investment driven to consumption driven. That process is essential in order to sustain growth across the growth period and to eliminate growth restricting factors. However, hasty implementation may increase risk. Even the hasty introduction of the raising of the minimum wage that is so desired by the common people could lead to economic deceleration, which would speed up inflation and constrict corporate performance. The Hu Jintao administration needs to adopt a multi-faceted approach, giving careful consideration to the effects of its actions and without relying too heavily on a single direction.

(Junya Sano)



India Strong economic growth expected to continue

Real GDP growth rate 8.6% for the period January to March, 2010

India's real GDP growth rate for the period January to March, 2010, was slightly in excess of expectations at 8.6% compared to the same period in the previous year. Also, the growth rate for October to December, 2009, has been revised upwards from the previous statement, from 6.0% to 6.5%, making the growth rate for fiscal 2009 (April, 2009, to March, 2010) 7.4%.

Reviewing January to March in terms of industrial origin, growth in agriculture was 0.7%, industry 13.3% and services 8.4%. Growth in the agricultural sector was stunted by the residual effect of the poor rainfall in the period June to September last year. Production activity in industry became further energized and manufacturing posted double digit growth at 16.3%, following on from October to December. The industrial production index shows that healthy domestic demand was reflected in the massive growth figures for capital goods (average 42.5%, January to March), intermediate goods (16.5%, similarly) and consumer durable goods (31.2%, similarly). In mining, coal and natural gas production was up, and in the wake of increased infrastructure construction and private housing building, construction maintained a high 8.7% growth.

In the services sector, government spending growth was well down on the same period in the previous year, when the worsening global financial crisis prompted the implementation of a range of economic stimulus measures. Therefore, community, social and personal services could only manage 1.6% growth. In contrast, the shift to positive growth in the number of visitors from overseas has brought about a recovery in hotel and transportation usage. Trade finance, which was rendered dysfunctional by the global financial crisis, has expanded significantly. Also, the number of new mobile telephone subscribers has grown rapidly. Against this backdrop, trade, hotels, transportation and communications accelerated by 12.4%.

Future prospects and possible causes for concern

The real GDP growth rate for fiscal 2010 is expected to be around 8.5%. It is expected that, as consumer and corporate sentiment continues to improve, domestic demand will accelerate its pace of growth and the export recovery can be sustained. In addition, as this year's rainfall looks likely to be the same as in normal years, agricultural production is believed likely to recover.

The employment and income situations look set to continue to improve, and the forecast is that personal consumption will probably post a high growth rate. In the urban areas, along with increased employment opportunities in construction, salaries of civil servants and other employees in the organized sector are expected to grow in double digits. In the rural areas, continued employment promotion programs, the recovery in agricultural production, and agricultural credit growth are working together to support higher levels of purchasing power among farmers. Reflecting this situation, purchases of consumer durable goods, and mobile phone subscriptions, are expected to grow smoothly in the future. Also, as regards fixed capital formation, since corporate sentiment is expected to receive a boost from the recovery of personal consumption and exports, an increase in new plant and equipment investment is expected. The fact that direct investment is robust is also a supporting factor.

Areas for concern are, first, inflation. The wholesale price index increase rate for April was 9.6%, year on year, exceeding the reserve bank's estimate, and the possibility that inflationary expectation will spread throughout the economy is growing. Meanwhile, it is expected that the value of new issue of government bonds will increase, compared to the previous year, meaning that liquidity management will need to be ever more careful. Second is the performance of the global economy. If the European debt problem gets any worse, there is a danger that India's economy will be affected in the form of slower exports to Europe and instability in capital inflow.

<Real GDP Growth Rates by Industrial Origin>

	FY2008					FY2009				
	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.		Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	
Real GDP	6.7	7.8	7.5	6.1	5.8	7.4	6.0	8.6	6.5	8.6
Agriculture	1.6	3.2	2.4	▲ 1.4	3.3	0.2	1.9	0.9	▲ 1.8	0.7
Industry	3.9	6.5	5.6	1.6	2.1	9.3	4.6	7.8	11.1	13.3
Mining, quarrying	1.6	2.6	1.6	2.7	▲ 0.3	10.6	8.2	10.1	9.6	14.0
Manufacturing	3.2	5.9	5.5	1.3	0.6	10.8	3.8	9.1	13.8	16.3
Elec., gas & water	3.9	3.3	4.3	4.0	4.1	6.5	6.6	7.7	4.7	7.1
Construction	5.9	9.8	7.2	1.1	5.7	6.5	4.6	4.7	8.1	8.7
Service	9.8	9.8	9.6	11.4	8.3	8.5	7.9	10.7	7.2	8.4
Trade, hotels, transp., comm.	7.6	10.8	10.0	4.4	5.7	9.3	5.5	8.5	10.2	12.4
Fin., insur., real est.	10.1	9.1	8.5	10.2	12.3	9.7	11.8	11.5	7.9	7.9
Comm., social, personal services	13.9	8.7	10.4	28.7	8.8	5.6	7.6	14.0	0.8	1.6

Source: Center for Monitoring Indian Economy

(Satoshi Shimizu)