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CHAPTER 4

FTF view: Analysis of possible socio-economic implications

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4.1. Introduction

This chapter sets out the opinions of the members of the FTF on possible trends in China's development and their impact on medium-sized Spanish companies and on certain industries in particular. The methodology used consisted of two separate activities:

- Firstly, two symposia attended by members of the forum. These consisted of a number of presentations by experts from throughout the world, group work and rounds of questions and answers on the talks and on other subjects directly raised by the team from Monitor Group, which organised the meetings. Using this methodology, Forum members had a chance to share their opinions and express their views, individually and in groups..
- Secondly, a survey. The aim was to establish the combined opinion of forum members on possible developments in China in timeframes of five and ten years, and establish what they considered to be the most likely scenario. Finally, they were asked for their opinion on the possible impact of Chinese development on medium-sized Spanish companies and on the main sectors.

The results are set out in this chapter, which is structured in three parts. The first part addresses the factors that will act as accelerators or brakes to China's future development. The second establishes the most likely scenario for the next five years in terms of GDP, foreign trade, monetary policy, investment flows and production opportunities in the rest of the world. The third and final part lists the main impacts that this situation will have in the areas under study, SMEs and industries that are most sensitive to developments in China.

4.2. What will accelerate or brake development of the Chinese economy?

The Future Trends Forum raised a large number of uncertainties regarding possible developments in China. Votes were taken and the members worked in groups on scenarios formed using a combination of five uncertainties.

The results were quite pessimistic. In general terms, the consensus was that the problems of social justice, the inefficient banking system and the forecast shortage in energy resources would have a very negative impact on China's future. Participants analysed both likely and unlikely scenarios in order to cover all possibilities.

The questionnaire set out some possible situations for each of these uncertainties over a five-year and ten-year period. First, forum members evaluated the influence of each uncertainty on China's future development and secondly, the likelihood of the various situations raised actually occurring for each uncertainty in the two timeframes.

This section is intended to create a series of indicators based on possible developments in these uncertainties: accelerators (or factors that will favour China's development) and brakes (factors that might hinder it). These indicators will make it easier to understand the scenario that the experts envisage developing, which defines trends in the main indicators marking the Chinese economy over the next five years.

4.2.1. Most relevant uncertainties

The experts at the Forum have assessed the influence of the eleven uncertainties with the greatest impact on China's development, which FTF has used to calculate the resulting averages. These evaluations suggest that there are no low-influence uncertainties; all uncertainties have a major influence. These can be classified into three groups: decisive influence, strong influence and relative influence.

Decisive influence
China's Global Orientation
China's impact on the world economy
Energy resources
Strong influence
Sistema bancario chino
Pollution and the environment
Trade relations between China and the US.
Science and Technology
Management of talent and skilled labour
Relative influence
Social and economic inequality
Corruption and political reforms
China as a trading partner of the EU

Notes

Uncertainties with a decisive or high influence generate the scenario, while relative-influence uncertainties characterise it. We can see that the uncertainties which most strongly affect the future scenario are China's orientation vis-à-vis the rest of the world, its impact on the world economy as a whole and obtaining energy to meet its production and growth needs. On the other hand, social inequality, corruption and relations with the European Union are all factors that characterise the scenario, but are not involved in creating it.

4.2.2. Accelerators/brakes

As well as assessing the extent to which each uncertainty influences the creation of the future scenario, the FTF awarded a plus or minus sign to each degree of uncertainty, depending on how it considers each one will affect China's development. Degrees of uncertainty with a plus sign (accelerators) are considered to be ones that will help China to continue developing in a sustained fashion until it attains living standards similar to those of developed countries. Degrees of uncertainty with a minus sign (brakes) are the ones that it is felt will slow down Chinese development. The assignment of accelerators and brakes has been divided into two timeframes: short- and medium-term (5 years) and long-term (10 years).

The accelerators and brakes were obtained using the evaluations made by the members of the FTF for the uncertainties as a whole.

The two tables below show the brakes and accelerators identified, in five- and ten-year timescales, classed in order of influence.

5-year trend.

	Uncertainty	Brake/ Accelerator	5-year trend
DECISIVE	China's impact on the world economy	●	<ul style="list-style-type: none"> Continued increase in China's impact on the world economy, with a bursting of the bubble ruled out Economic instability resulting from shortage of energy resources compared to limited resources China accepts the rules imposed by other global economies
	Energy resources	●	
	China's Global Orientation	●	
STRONG INFLUENCE	Management of talent and qualified labour	●	<ul style="list-style-type: none"> Shortage of qualified labour alleviated by an increase in university graduates The government implements a policy on investing in science and technology No change: pollution and environmental problems continue to grow Tension continues between US and China No change: banking problems continue, although without triggering a financial crisis
	Science and Technology	●	
	Pollution and the environment	●	
	Trade relations between China and the US.	●	
	Chinese banking system	●	
RELATIVE	Social and economic inequality	●	<ul style="list-style-type: none"> Gradual improvement in social inequality thanks to a demographic slow-down and government policy Collaboration agreements between China and the EU continue Continued problems with corruption
	China as a trading partner of the EU	●	
	Corruption and political reforms	●	

● Accelerator ● Brake

10-year trend.

	Uncertainty	Brake/ Accelerator	10-year trend
DECISIVE	China's impact on the world economy	●	<ul style="list-style-type: none"> Continued increase in China's impact on the world economy, with a bursting of the bubble ruled out Investment in new energy sources and improvement in the way oil procurement is managed China increases its participation in the creation of agreed rules governing the world economy
	Energy resources	●	
	China's Global Orientation	●	
STRONG INFLUENCE	Management of talent and qualified labour	●	<ul style="list-style-type: none"> Shortage of qualified labour alleviated by an increase in university graduates The government implements a policy on investing in science and technology No change; pollution and environmental problems continue to grow Tension continues between US and China There is a reform of the banking system
	Science and Technology	●	
	Pollution and the environment	●	
	Trade relations between China and the US.	●	
	Chinese banking system	●	
RELATIVE	Social and economic inequality	●	<ul style="list-style-type: none"> Gradual improvement in social inequality thanks to a demographic slow-down and government policy Collaboration agreements between China and the EU continue Anti-corruption measures improve perceptions vis-à-vis corruption
	China as a trading partner of the EU	●	
	Corruption and political reforms	●	

● Accelerator ● Brake

4.2.3. Development of degrees of uncertainty over five years

In this section, we will describe the uncertainties according to their degree of influence in determining the scenario. Since the scenario is defined for a five-year timescale, we analyse the factors that will act as accelerators during this period and also examine what the ten-year trend will be.

4.2.3.1. Decisive Uncertainties

a) Decisive accelerators

- China's impact on the world economy: China's impact on the world economy continues to grow and it seems unlikely that the bubble will burst (as many have speculated) within the timeframe under examination here. If a crisis did occur, it would not be before 2015, when social instability might derail current trends.



What the experts say

- The problems will gradually be solved, avoiding the outbreak of a possible crisis.
- The concurrence of favourable conditions (political, social and economic) and positive aspects (good perspectives in education, intellectual property, maturity of markets, etc.) will help maintain this situation.
- The world economies will collaborate with China to prevent the bubble bursting, because if it did it would affect all countries.
- In the longer term it is possible that there might be a more radical adjustment, but not in the period analysed.
- In the long term, China will go from being a developing country to a developed country with a standardised growth rate.

b) Decisive brakes

■ **China's Global Orientation:** in the next five years, China will continue to accept the rules imposed by international organisations and the world's ten strongest economies, although it is playing an increasingly active role as the process of integration continues.

What the experts say

- China has a very protectionist government.
- For the time being, its economy is centred more on the domestic area.
- It is still a beginner, learning the ropes.
- It prefers to play a less active role for fear of reproducing the mistakes of the past.
- Its position is still not sufficiently solid or influenceable.
- It is gradually acquiring technology and learning the rules of the international market.
- Both the government and the public have a positive attitude towards international integration (one example is the revaluation of the Yuan).

■ **Energy resources:** although China is gradually coming to grips with its energy problems, over the next five years the situation will generate major economic instability because of an increase in demand being met by limited resources. The perception is that, in a ten-year scenario, the situation will be dealt with thanks to the measures currently being taken to control the situation and the action of market forces to prevent instability.

What the experts say

- The problem generates major tensions on a global scale.
- Demand is growing not only in the manufacturing industry, but also because of the increase in the country's wealth (petrol for cars, electricity in houses, etc.).
- In the long run it will be necessary to invest in technology, reduce the power required by the manufacturing industry and avoid wastage of oil.
- In the short term, the government will carry out actions geared towards gradually resolving the imbalances and stabilising the situation. The measures adopted will include:
 - Measures related to the supply of oil (building of more modern refineries, agreements with other countries, construction of pipelines or even the creation of a strategic national oil reserve).
 - With less enthusiasm, there will be investment in projects related to alternative energy supplies (natural gas, wind power, nuclear power stations—if environmentalists do not object, etc.).
 - Energy saving campaigns are being launched among the population.
 - Investment is going into research into renewable energy (the recycling industry).
- An example of China's attempts to gain access to larger energy sources can be seen in the oil company, CNOOC's, 15.3 billion take-over bid for the American company Unocal.

4.2.3.2. Strongly influential uncertainties

a) Strongly influential accelerators

■ Management of talent and skilled labour: Chinese society is characterised by a high degree of specialisation in technical courses. The result is a lack of qualified personnel to run businesses. Over the next five years, this situation will improve thanks to an increase in university graduates and because of the cultural bridges that have been created with integration between China and Europe. Not until the long term future, however, will Chinese society have access to qualified personnel resulting from a combination of education and experience.

Notes

What the experts say

- China is working to alleviate the shortage of qualified personnel with an international profile. In 5-10 years' time this will be a minor problem.
- Favourable aspects:
 - China has excellent dealers, well established in the Chinese communities around the world, to help build the bridges it needs.
 - The capacity to create and manage businesses has improved at a remarkable rate.
 - The number of qualified personnel is increasing thanks to an increase in postgraduate students, an increase in the number of Chinese students travelling abroad and the creation of cultural bridges thanks to western companies operating in China.
 - China already produces more postgraduate students in science and technology than Europe; it will continue to invest in its specialised labour with a view to penetrating the world market, which is so technologically specialised and sophisticated.
 - In the medium term, education will begin to work to favour a business culture and international integration.
 - Higher education is already transforming itself under its own initiative, through partnerships with foreign universities and internal reforms. Domestic competition will help to further bring supply and demand into line.
 - Returnees are already making a difference, helping Chinese companies to go global.
 - As Chinese companies carry out more international takeover operations (e.g. Lenovo), the phenomenon will accelerate.
 - In time, biculturalism and company-orientation will gradually take hold.
- Unfavourable aspects:
 - Lack of contact with other countries, linguistic problems and relatively small operations are preventing human resources from maturing in quality. Over the next 10-20 years, this situation will improve.
 - The government is not channelling this talent well, and is failing to gear it towards the aim of national development.

- Science and technology: The government will continue to be committed to investment in technology, especially in the long term, maintaining a policy oriented towards making its economy competitive on the global market.

What the experts say

- Technological development is a state matter for China, as well as a need (although not the only one) for economic growth.
- The Chinese government is basing its policy on technology and is increasingly investing in research and development, although it is still far from achieving the necessary level.
- In many areas, there should be more advances in science and technology than over the last few decades, although it will never attain the levels of uniform, widespread development of technology-oriented countries like Israel.
- China is very developed in some areas of R&D (spatial technology) and very underdeveloped in others. This trend will continue over the next five years. However, in the medium term (5-10 years) China must begin to develop its own technology, since it cannot go on keeping production costs down by keeping salaries low.
- China wants to invest in talent and knowledge, and knows that in order to be a world leader, it cannot be left behind technologically. Competition, growth and an improvement in the education system will bring more and more technological progress.
- Growth depends on interest in the private sector; experience in other countries shows that technological advances do not come from government projects, but from private companies working in conjunction with research institutes (for example, universities, laboratories, etc.), and government support in this strategy is therefore very important. Under these circumstances, technological development in China will grow.

b) Strongly influential brakes

- Pollution and the environment: problems with pollution continue to increase. The government is not taking action to solve the problem and meet Kyoto targets for reducing carbon dioxide emissions. The outlook is not much better for the next ten years.



What the experts say

- China's passive attitude is due to several factors:
 - It considers it to be a global problem.
 - It is not a priority concern for a developing country.
 - It is a problem of education and awareness-enhancing, and needs time to solve.
- Although in the period under analysis, it seems unlikely that there will be a major change in attitude, the problem of pollution will mean that China will ultimately have to face up to the harmful impact of natural deterioration (environmental degradation, disease, etc.). This will be further compounded by the impact of acid rain on neighbouring countries, increasing pressure to bring transnational pollution under control.

■ **Banking system:** There will be no radical changes in the banking system in the short term, but neither will there be a financial crisis, despite continued inefficiency of the system. In a ten-year timeframe, however, the banking system will undergo a transformation which will definitively stave off the threat of a crisis.

What the experts say

- The main features of the Chinese banking system are as follows:
 - High level of state control.
 - The model differs from the banking model in OECD Countries and does not adhere to international standards on prudence in the financial system.
 - Inefficiency of the system, which needs capital, experience and good policy.
- Measures will be introduced to avoid collapse (for example, revaluation of the Yuan, use of foreign reserves to cover bad debts, etc.).

The government is taking a very active role in dealing with the problems: it is giving instructions and investing in improved balances, allowing the influx of foreign capital to get the country into shape, favouring the transfer of knowledge, etc.

The government has prioritised an improvement in credit management and the distribution of resources, although it is a long way from achieving western-style functioning of the system.

The banking sector is demonstrating its skill and its predisposition for change in order to increase its efficiency (liberalisation of the Yuan, playing down of NPLs, etc.).

■ Relations between the United States and China: there have been attempts at collaboration between the two countries (floating of the Yuan, copyright, export quotas, etc.). However these have not been very successful, leading to tension. In the long term, collaboration will be more positive and will strive to maintain the balance through collaboration agreements in order to resolve problems.

What the experts say

- As interdependence grows, the obstacles will have to be hurdled, since it is in the interests of both countries to get on well.
- The key risk to bilateral relations might be related to military power. China and the United States will clash over ideology and economic policy.
- Energy needs will drive politics, and both blocks have a clear interest in controlling the issue.
- Over coming years there will inevitably be a power struggle between those who currently hold sway and the emerging new power. China has begun to question the United States' role as a rule setter.
- Increasing collaboration: the two countries have come to an agreement to resolve existing tensions and maintain the balance.
- The role of the WTO will be of key importance as Chinese officials gradually agree to cooperate with multilateral organisations.
- In the end, China and the United States may develop the same type of balanced economic relationship as that which currently exists between the United States and Europe.
- The bilateral relationship between the United States and China will always be multidimensional. Business and financial relations will lead the way, followed by political relations, which will sometimes have to be blocked to avoid disturbing the relationship.
- Out of pure necessity, both parties will do everything in their power to ensure a fruitful relationship without direct confrontation (perhaps the relations between the United States and Japan are a good example of how relations between China and the United States may develop).

Notes

4.2.3.3. Uncertainties with a relative influence

a) Accelerators with a relative influence

■ China and the European Union as economic partners: Most of those surveyed were upbeat about relations between China and the European Union, considering that the two would continue to enter into cooperation treaties (treaties on investment, technological collaboration, trading relations and services, etc.), creating fresh opportunities for both sides.

What the experts say

- China and Europe are both large markets with potential benefits for the other. Chinese growth must be seen as an advantage for both sides, offering a market full of opportunities.
- China will take advantage of its relationship with the European Union to curry favour with international bodies (WTO), despite efforts by the United States to limit its influence.
- The European Union is benefiting from the tense relations between China and the United States to improve its relationship with China. China and the European Union share complementary needs and skills.
- Historically, Europe has considerable experience in dealing with other cultures, civilisations and countries.

- Economic inequality and social injustice: the problem will improve over coming years due mainly to a demographic reduction and the measures the governments have already begun to introduce. In the longer term, government measures will gradually increase, improving the social situation, though without actually achieving social equality.

What the experts say

- This is one of the major challenges facing the government, as evidenced by the investment the government has earmarked for underprivileged areas in the east and its search for alternative energy sources to continue economic growth. It will not be possible to measure the impact for at least another decade.
- Public expectations regarding the breakdown of the system improve people's attitude to problems of inequality.
- Through development programmes drawn up by the government, an increasingly large segment of the population is directly or indirectly involved in the country's economic development, thus increasing their social and economic expectations.
- Given the size of China and the present differences, equality will never be achieved between the different regions, although the social problems will not be unmanageable.
- The situation will improve with the policies adopted and with the economic growth of the country.
- There are many supporting countries to help in their success and a lot of room for improvement, and it therefore seems unlikely that these problems will affect transition towards a market economy.

b) Brakes with a relative influence

■ Corruption and political reform: while the majority think that in the short term the institutional reforms adopted by the government will not serve to reduce corruption, it does appear that these measures will prove positive in the long term. Despite these reforms, new forms of corruption will emerge in the medium and long term. A smaller group feels that government measures will be insufficient and that there will therefore always be corruption.

What the experts say

- The stronger the economy, the less the corruption. This will eventually happen in China as it has in many other countries.
- The fight against corruption will be a very long battle: inequalities and the inheritance of power will continue to maintain a very high level of corruption.
- Corruption is reduced by the introduction of institutional reforms in corrupt areas (banking, customs system, land administration, etc.) and pressure exercised by the government.
- Corruption is inextricably linked to the Chinese economy.
- Corruption will gradually be seen to be anti-productive and the government will put an end to it in order to promote effective growth and global influence.
- Corruption will continue, but its effects will diminish over time. In any case, structural corruption will continue to exist, as there is in other countries.
- Corruption hinders greater transparency, which impedes the introduction of a market economy. Long-term corruption is a critical problem for an open economy.
- Greater political and economic openness inevitably leaves the door open to corruption. All countries take some time to develop a system for fighting corruption. Democratic reforms and reforms in the media will be needed.
- Any measure in this field will take time, as it will take a whole generation to change its position on key issues.
China has staked a lot on improving its reputation with regard to transparency, and it will therefore gradually manage to make progress.
- This is a continuous problem which requires a great effort to solve. The general situation is improving under the present government.

4.2.4. Change in trend from five to ten years

Of the factors analysed, those that are presumed to act as accelerators in the next five years will continue to be so over the next ten. However, nearly all the factors which in the five-year timeframe represented a brake will take effect in the 10-year one, thanks to the measures being introduced to correct that negative influence.



The table below shows the brakes that in the ten-year time frame will be transformed into accelerators, and some measures that will bring about this change.

Transformation of brakes into accelerators.

Brakes at 5 years	Accelerators at 10 years	Reason for change
China as a complier with global rules	China collaborates in creating global rules	Integration and growth of China Government policies: - Investment in energy sources - Investment in technology - Awareness-heightening campaigns
Shortage of energy resources	Increased efficiency in managing energy sources	Government interventionism: - Revaluation of the Yuan - Rationalisation with foreign reserves
Crisis in the banking system	Balanced banking system	Collaboration agreements: - Floating of the Yuan. - Copyright. - Introduction of government anti-corruption reforms
Tense relations between the United States and China	Problem solving sped up	- Strength of the economy - Improved perception of corruption
High levels of corruption	Improvement in perception of corruption	

4.3. What will happen?

We have defined the most likely 5-year scenario for all of the main factors shaping a country's economy. These are the opinions of the forum members on the way current trends will evolve in the short- and medium-term future in China.



4.3.1. Trends in GDP

Notes

The economic awakening of the "great dragon" meets all the classic characteristics of a young economy. Like other South East Asian economies, the first two decades of economic reform have stimulated a growth rate of around 8%. As the country matures economically, the growth rate will fall. However, in absolute terms, growth in the Chinese economy will continue to be much greater than in Western economies.

According to the FTF experts, this economic growth will allow China to consolidate its position as a world leader. Specifically, various aspects will have a direct and positive effect on China's GDP growth line:

- **Reform of Monetary Policy:** The Chinese government has allowed slight floating of the Yuan, which until a few months ago was tied to the dollar. In the political arena, this revaluation will impact positively on the balance of payments with United States and, as a result, also on its bilateral relations. In the internal arena, this

flexibility will give the government greater room for manoeuvre in managing its domestic monetary policy and allow it to reinvest the 200 billion dollars formerly spent maintaining the fixed exchange rate, for example, in education or infrastructures.

- Telecommunications and direct foreign investment (DFI): these will continue to be the driving forces of the economy. Once a certain point has been reached, domestic consumption will also give the economy an added boost.

According to the experts, China's leadership and its new position of power in the world economy are imminent and inevitable.

On the other hand, though, there are certain decisive factors which cast a shadow over the overall picture:

- Growth is very uneven in different provinces: these differences will be magnified by the development of the more developed cities and provinces. As explained in the previous chapter, there are vast differences between the four Chinas: in Shanghai, Hong Kong and Beijing, per capita income stands at around \$4,000, compared to a national average of around \$1,200.

- The financial system needs to be reorganised: there has been much talk about the possible collapse of the Chinese banking system, but the FTF experts discount this possibility, given that the problem is not a shortage of funds, but bad debts. The overdue reform must be oriented towards proper awarding of loans, governed by the laws of supply and demand.

The combination of positive and negative aspects suggests that there will be a "provoked" and controlled cooling-down of the economy. Even if the growth rate stabilises, falling slightly to 8%, areas such as domestic consumption will be strengthened and, in the long term, less-developed provinces will experience growth and reforms will be set underway in the areas where they are most needed (for example, in the financial system). As a result, transition towards a full market economy will be smooth: China will maintain and consolidate its position in the globalised world.

4.3.2. Trends in foreign trade

It is forecast that the industries currently at the forefront of exportation will maintain their lead position. In the area of foreign trade, the trend in the balance of payments will be maintained: the trade surplus will continue growing and increasing. The FTF experts agree that the growth curve contains no indicator pointing to any radical change in the near future (the next five or ten years): today, the manufacturing surplus is offsetting the deficit in other sectors (agriculture, food industry, mining and oil).

The situation will change almost imperceptibly in some industries:

- There will be a gradual increase in the price of raw materials (steel, aluminium, copper, etc.). In the long term, China does not have the raw materials it needs to continue supplying its industry at the current rate: industrial growth will reach a peak and give way to development of the services sector.

- Nonetheless, some experts note that the significant increase in the price of energy and raw materials over the last two years may result in a slight downward adjustment in these prices.

One of the pillars of the Chinese economic model is foreign trade, over and above the country's domestic consumption. When industries such as agriculture and the manufacturing production chain mature, China will be forced to switch to a services economy, grounded in domestic demand. For this to happen, the purchasing power of the middle classes will have to be consolidated. The motor industry is a good example: in the future, Chinese car manufacturers will have to compete in terms of quality, design and technology with foreign manufacturers, offering consumers a striking product that is environmentally compatible and can operate using the available energy resources

4.3.2.1. Sino-Spanish trade

To position themselves on this market, western economies will have to exploit available market niches: technology, luxury products and services. Spain currently runs a trade deficit with China and the evolutionary leap forward needed to turn this situation around will require greater investment in technology and research and development.

However, the balance of payments gives a biased perspective of the overall position. The view given by the wider context is closer to the reality. Chinese assembly lines are supplied with by-products manufactured in other countries: for example, the design, materials and dyes used in the clothes manufactured in China come from companies based in other countries. In this regard, Spain has two opportunities: to export added value products or to be a distributor of by-products for Chinese industry.

The Future Trends Forum recommends capitalising on the growth potential of certain high quality articles or articles with designated denominations of origin, such as olive oil, leather goods and final chemicals (prepared from products semi-finished in China). Although to date these items have only made a timid debut on the Chinese market, they have great potential given the emergence of the country's new middle class.



4.3.3. Monetary policy

Although a 2% revaluation is unlikely to bring any radical or immediate change, it does mark a volte-face in Chinese monetary policy and a first step towards a free-floating Yuan. A flexible interest rate is indispensable if China is eventually to form part of the group of more developed countries. FTF experts consider that within two years, by 2007, the Yuan will have appreciated by 10%. Its main hurdle will be to keep labour costs low at the same time. Similarly, a partial float gives the other variables (monetary policies of other countries, exports, imports, investments, etc.) enough time to adjust to and absorb the revaluation.

The Future Trends Forum analysed the possible consequences of the new monetary policy in various areas:

- The Chinese government will be able to reinvest the money it previously used to maintain dollar parity (\$200bn per year) in other areas, such as infrastructures and education.
- Inflationary pressures will continue and interest rates will stabilise.
- For the Chinese business sector, the floating of the Yuan will have a positive impact: Chinese multinationals will not suffer a fall in demand for their products, even though they may become more expensive as a result of fluctuation. The cost of manufacturing and, thus, of exporting, will continue to be competitive even with a stronger Yuan. In addition, access to attractive markets (the European Union, for example) will make it possible to boost capacities that have not yet been developed, such as marketing and design, or, in any case, to create a more effective business model that will make it possible to continue exporting. The doors will also open to foreign Investment, leading to an increase in mergers and acquisitions by Chinese companies.
- As for the balance of payments with the United States, there will be no reduction in the American deficit; nonetheless, the limited revaluation of the Yuan is a first step for improving China's relations with its largest trading partner. It therefore seems probable that the American administration will put less pressure on China in this aspect. However, the Chinese government will continue to direct the country's monetary policy independently of international pressure. Once a balance point is reached similar to the pre-revaluation situation, the pressures on China will again increase until it is forced to take further steps to liberalise its currency.
- Revaluation of the Yuan will have a negative impact on the direct foreign investment China receives.

- The new Chinese monetary policy will possibly lead to a revaluation of other currencies in the region.

4.3.4. Direct foreign investment in China

All prospecting studies of China suggest that direct foreign investment (DFI) in the country will continue to grow, backed by the stability offered by a high rate of accumulated foreign reserves. At the same time, DFI will tend to diversify: investments will centre on a model of 100% foreign-owned company, at the expense of the joint-ventures set up until now.

On the other hand, no one is willing to say whether a possible revaluation of the Yuan or the discovery of a bubble might have a negative impact on the investment the country has been receiving until now. DFI in China is likely to slow down, but growth is unlikely to be negative. Indeed, the FTF experts say that the amount of foreign currency invested in China will be the same in absolute terms, but the growth curve will be slower. Investment opportunities will spread to inland China, increasing its market share.

In the current world economic context, investing in China is a strategy that Europe must adopt to protect its economy. Now, thanks to diversification and expansion of DFI into other Chinese provinces, Spain has a chance to increase its level of investment. To date, however, this opportunity has not been fully seized.

Low salaries and high productivity offer competitive advantages which will be optimised when the logistics and technology are developed. Companies throughout the world will continue to migrate towards China over the next ten years, making this country a secure and fruitful investment opportunity.

4.3.4.1. Sectors

Notes

The FTF experts analysed the trend in sectors that receive most DFI and rated them according to their growth potential. The first across the line is several lengths ahead of the second. Three industries take third place with the same score. If we also take into account the Chinese government's priorities and the pressure brought to bear by the World Trade Organisation, it is anticipated that the industries with most growth will be as follows:

1. Services.
2. Construction.
- 3.1. Telecommunications and transport.
- 3.2. Manufactures.
- 3.3. Property industry.
4. Agriculture.

The FTF scored the services sector above manufacturing (currently the industry that receives most investment) because in the long term, China will go from being an export platform to become a demand market. Until this happens, the economy of the country will depend to a large extent on DFI.

There will be greater regulation of the second industry in the list-construction-and in the property market, not only in the large cities such as Shanghai, but also in cities with a low population density, such as Zengzhou (in Coastal China, using the division explained in the last chapter), where an entire city is being laid out to house the growing middle class.

Investment in telecommunications will stabilise, since it requires outlay that only the large multinationals can afford and it will not be easy to take on the local operators (Huawei, ZTE, etc.) on their own turf.

The primary sector-agriculture-urgently requires an injection of economic and technological investment. However, the changes must be gradual, given the direct consequences that modernisation would have on labour, as the industry could not absorb the surplus quickly enough.

4.3.5. China as an overseas investor

According to the FTF experts, investment from and in China are inexorably linked. If one falls, so does the other. As the country consolidates its position on the global stage, investment from and in China will increase.

It is worth remarking on the investment model that Chinese companies use to get round strict legal regulations, using foreign companies whose brand name they purchase. Nonetheless, the FTF believes that the situation will change. Chinese companies have innovation written into their genes and they will emerge to compete on the global stage in coming years.

Most outward flows of capital are currently concentrated in the US Federal Reserve. It is a safe way of saving... but it is not an attractive one: investing in raw materials and technology is much more appealing and Chinese companies will switch to this method.

4.3.6. Manufacture in China?

The FTF advises that any medium-sized company considering international expansion in the next five years should weigh up where it wants to expand to, what market it wants to target and where it should be producing. Although China might seem like a logical choice, Eastern Europe, India, Vietnam and North Africa are equally valid opportunities for many companies. Given the geographical proximity and cultural affinity, this section will only compare China with Eastern Europe, weighing up several advantages and disadvantages, not only involving labour costs,

but also the general savings to be had by relocating in one or other of the two regions

Advantages of producing in China and Eastern Europe.

Advantages of producing in China	Advantages of producing in Eastern Europe
1. In the forecast timeframe, China will continue to be the most competitive option thanks to its cheap labour (a third of the cost in Europe).	1. Cultural proximity
2. Complete and ideal ecosystem: distributors, qualified labour, etc.	2. Physical proximity: reduction in transport costs and times (provided the target market is in Europe)
3. Local market in development. Great potential. For the time being, sufficient critical mass.	3. As the first phase of internationalisation, it is simpler than China.
	4. Poland and Romania: great potential. for growth as supply and demand markets (though always less than China).
	5. Fewer customs costs
	6. Legal framework more stable than in China.
	7. Telecommunications network faster and more secure.

4.4. Possible impact for Spanish SMEs

The final part of the FTF's analysis revolves around the main consequences that the forecast scenario for development of the Chinese economy would have on Spanish companies in the next five years. We have selected the industries which are likely to see the greatest (positive or negative) impact as a result of Chinese economic development.



Finally, using the scenario defined and working analogously with that drawn up for Spanish companies, we have defined the essential threats and opportunities for each industry identified and included, as applicable, recommendations for action.

4.4.1. Groups of companies analysed

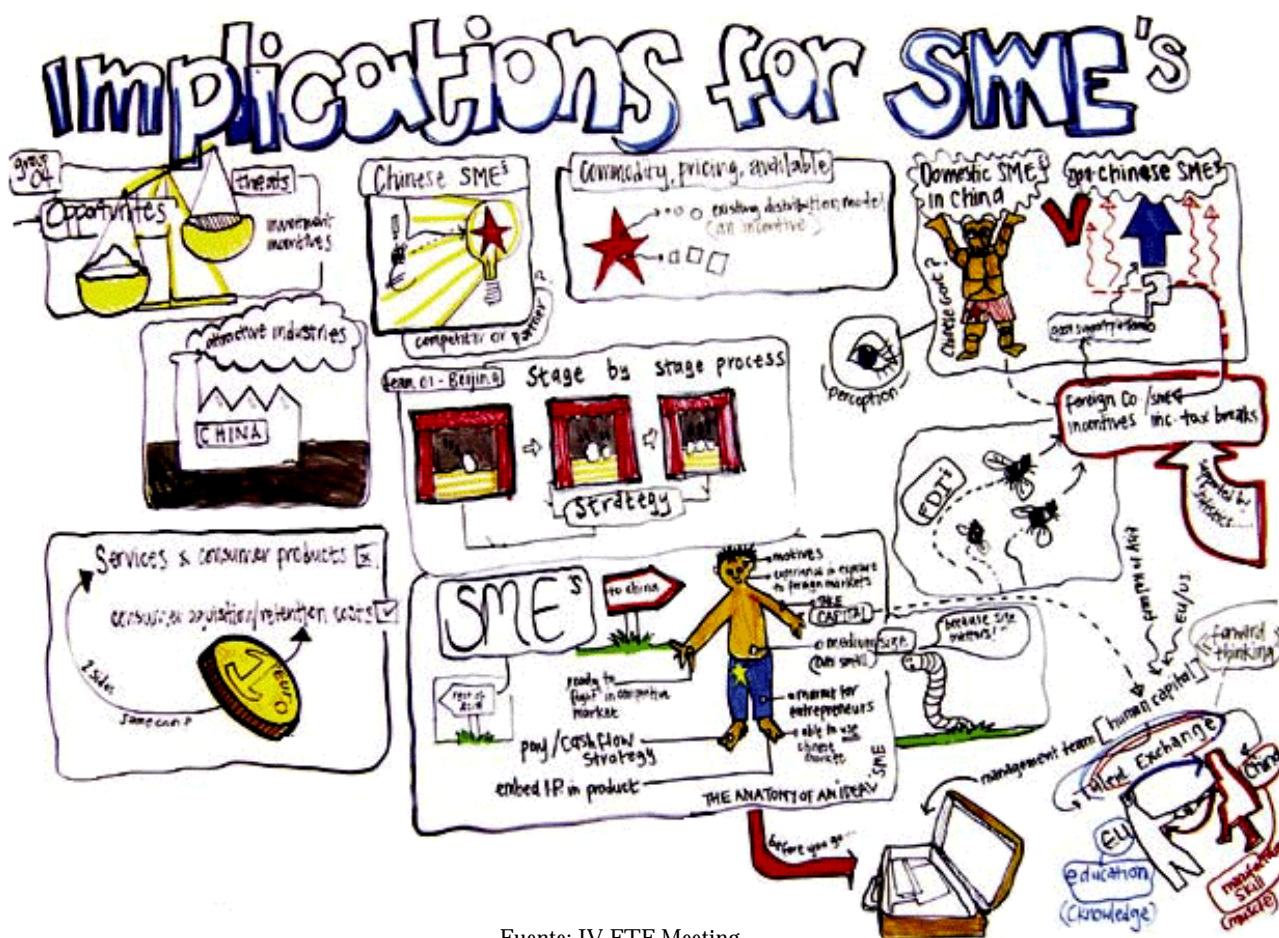
Companies are affected in different ways depending on whether they form part of the Chinese phenomenon or not. Consequently, we have analysed the impact on two groups of companies: companies that use China to operate their business (Spanish SMEs in China) and companies that stay in Spain and have Chinese influence (Spanish SMEs in Spain). The impact for the SMEs in each industry is included in the industry-specific analysis.

■ Spanish SMEs in China. Companies whose business strategy interacts with the Chinese market:

- Spanish companies that consider China as a market for their products. China is the destination of their products.
- Spanish companies that consider China as a market for their services. China is the destination of their services.
- Spanish companies that consider China as a source of supply. They buy Chinese products cheaper to sell them in Spain.
- Companies that produce in China and sell in China or in Spain (outsourcing).

■ Spanish SMEs in Spain. This group includes companies that passively receive the influence of Chinese growth.

Implications for SMEs.



Fuente: IV FTF Meeting.

4.4.2. Sectors with greatest impact

Based on the FTF's assessment, we have taken the Spanish industries and sub-industries that are most affected by the Chinese phenomenon. We have taken into account both the opportunities derived from large-scale growth in the country's economy and the risks that businesses may face.

The results of this assessment are shown below, in order of importance:

- Consumer goods:
 - Textiles, garments and footwear.
 - Food and drink.
- Services:
 - Leisure, tourism and catering.

- Energy:
 - Oil.

4.4.3. Threats and opportunities by sector

This block shows the threats and opportunities for Spanish SMEs in each of the industries described above. A table is given for each sub-industry with a summary of the threats and opportunities.

4.4.3.1. Consumer goods

a) Textiles, garments and footwear

The situation of the Spanish textile industry is complicated, and China is responsible for 30% of the industry's trade deficit.

Although Spanish companies cannot compete on price, they have competitive advantages over China, such as branding, product quality and design.

Chinese companies, fully aware of their weakness in the manufacture of consumer goods, have already begun to develop strategies geared towards improving the quality of their products, with major investment in design, etc. So whereas the transfer of the greater costs to prices is reducing China's competitive advantage against Spanish producers, an increase in the quality of Chinese products is reducing the edge that Spanish companies hold.

However, there are also opportunities for Spanish companies. Producing in China is part of corporate internationalisation, an absolute must in a global economy. Production can be outsourced to China, which can then be used as a distribution platform for the rest of Asia. This is already very common practice among the main Spanish textile chains.

Notes

The quality of the products, recognised branding and western designs are in high demand among the Chinese public. This still represents a business opportunity for Spanish companies that can offer these advantages and which wants to capitalise on the growing demand from the Chinese themselves.

Another interesting possibility for Spanish companies involves entering into partnership with companies in China, sharing resources, talent, market and logistics. They can also collaborate with Chinese manufacturers in the export market or look for a partner in China to unite the two typical strengths each side has to offer: volume and low cost with know-how and design.

Textiles, garments and footwear

Opportunities and Threats	SMEs in China	SMEs in Spain	Descripción
Quality of Spanish products	●		<ul style="list-style-type: none"> The combination of the recognised quality of Spanish products and the increased purchasing power of Chinese consumers holds out great opportunities for increasing the export market to China.
Differentiation by brand and design and customer care	●		<ul style="list-style-type: none"> Spanish SMEs with the capacity to offer differentiated products well established in terms of design, brand image and customer attention can obtain competitive advantages and larger margins.
Reduction of competitive edge	●	●	<ul style="list-style-type: none"> It is only a question of time before Chinese companies, who are fully aware of their weaknesses in the manufacture of consumer goods, improve the quality, design and branding of their products.
Replicas	●	●	<ul style="list-style-type: none"> There is a great risk that they will "replicate" the designs, labels, etc. This is a very competitive market in the fight for registered brands.
Increase in Chinese prices Chinese manufacturers	●	●	<ul style="list-style-type: none"> The price of Chinese products will increase, thereby reducing the current difference between Spanish and Chinese prices.
Leather products	●		<ul style="list-style-type: none"> Given the high price of some Spanish leather goods, Spanish companies could offer Chinese leather goods at more competitive prices on the Spanish market.
The trend in the textile industry continues	●		<ul style="list-style-type: none"> The massive influx of textile products into Spain at very competitive prices continues to grow.
Spanish attitude	●		<ul style="list-style-type: none"> The passive attitude of Spanish businesses is allowing China to race through the learning curve and gradually penetrate the Spanish market, thanks to its cost advantage. In addition, since the outlook for SMEs in this industry is quite uncertain.
Investment by Spanish companies	●		<ul style="list-style-type: none"> Spanish SMEs may become the target of investment by Chinese companies.
Partnership with other companies	●		<ul style="list-style-type: none"> Entering into partnership with other companies to lever their way in and share resources, logistical chain, local market and talent.
Collaborating in the Chinese export market	●		<ul style="list-style-type: none"> Collaborating with Chinese manufacturers in the export market for their products.
Collaborating with Chinese manufacturers	●	●	<ul style="list-style-type: none"> Spanish SMEs that offer design and know-how could look for a local partner that wants to improve its product, either for export or for domestic sale to a more demanding market.
Uniting volume and low cost with know-how and design	●		<ul style="list-style-type: none"> Spanish SMEs have the opportunity to invest in helping Chinese manufacturers in design, distribution, marketing and sales.
Outsourcing	●		<ul style="list-style-type: none"> Excellent opportunity for relocating production and using China as a distribution platform for Asia.
International expansion	●	●	<ul style="list-style-type: none"> Analysing the possibility of international expansion, since the outlook for SMEs in this industry is quite uncertain.

● Opportunities ● Threats

b) Food and beverages

The special characteristics of the Chinese food and drink market-highly saturated with strong competition-will make it difficult for Spanish companies to make any inroads here.

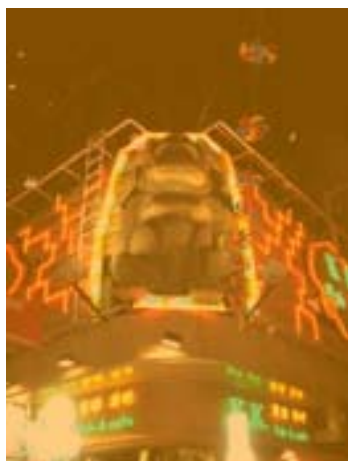
Given this situation, the wisest development strategy for businesses in the industry is to use China as a launchpad for exporting to other countries, taking advantage of its lower production costs. However if a Spanish company does want to penetrate the Chinese food and beverages market, the experts recommend a selective strategy of finding a specific niche with little or no competition, where it can satisfy a latent demand for typical Spanish products (wine, ham, oil, etc.).

For companies facing Chinese competition in Spain, their main advantage lies in the preferences of the Spanish population, which prioritises hygiene of foodstuffs over price, given that there is still a perception that the Chinese food industry does not meet European standards on quality and safety.

Food and beverages.

Opportunities and Threats	SMEs in China	SMES in Spain	Description
Difficulties of investment Exports of Chinese food	●		• Added to the lack of certainty faced by the industry small companies also face the difficulty of penetrating the market; there are only opportunities for more dynamic manufacturers of mass consumer goods.
Exportation through China	●		• Opportunity for growth and expansion taking advantage of low export costs through China.
Strategy	●		• Analyse your strategy for promotion and expansion, trying, for example, to create a brand or cash in on the exclusivity of typical Spanish products (ham, olive oil, olives, wine, etc.).
Consultation bodies	●		• There are many public and semi-public institutions which can be consulted and asked for help. Some may even finance part of the operation.
Competition	●	●	• It is very difficult to compete with Chinese products, and the challenge must therefore be to offer products of greater added value or ones which are exclusive to Spain.
Investment in Spanish companies		●	• Spanish SMEs may become the target of investment by Chinese companies.
Hygiene		●	• China does not meet European standards of hygiene and respect for the environment, giving Spanish products a competitive edge.
Exports of Chinese food		●	• Emergence of a trend that is set to increase, namely the exportation of food (fruit and vegetables) from China to other countries.

● Opportunities ● Threats



4.4.3.2. Services Sector

a) Leisure, tourism and catering

The last 25 years of major economic growth have enabled a significant increase in living standards and the emergence of population sectors with a relatively high purchasing power. One of the most dynamic sectors in the future is likely to be leisure, tourism and catering.

Spain is a tourist super-power with long experience and understanding of the industry, and it must seriously consider its best course of action if it wants to be involved in this new market.

The World Tourism Organisation forecasts that by 2020, China will be one of the leading "issuers" of tourists in the world (100 million Chinese will travel abroad as tourists). In just four years, Spain could receive 250,000 tourists from China. The Chinese tourist industry therefore holds out business opportunities both in Spain-to cover the needs of Chinese tourists (leisure, catering, etc.)-and in China, where companies can act as in situ wholesalers and retailers.

Spain can cash in on the Beijing 2008 Olympic Games, using the experience it acquired in Barcelona 1992 and its tradition and national and international experience in these sectors. However, there is also a risk that the business that has been invested in may consequently go to the wall if it lacks a long-term vision.

However, some remaining difficulties need to be resolved. On the one hand, the government has to be more flexible in terms of granting visas, which are currently restricted to prevent illegal immigration. At the same time, there also needs to be an improvement in coordination between airlines, tour-operators and hotels to make travelling from China to Spain much easier than at present. Another important factor is the existing Asian competition in this sector

Leisure, tourism and catering.

Opportunities and Threats	SMEs in China	SMEs in Spain	Description
Investment opportunities in leisure and tourism in China	●		<ul style="list-style-type: none"> The leisure and tourist industry is a market in sustained growth because of the constant increase in the wealth of the Chinese population. This represents an investment opportunity for Spanish companies providing these services
Olympic Games	● ●		<ul style="list-style-type: none"> The 2008 Olympic Games are a chance to enter the Chinese market, but at the same time they pose the threat of non-continuity of the business. The goal should be to stay in the market, not only to meet the needs of the Olympics, but also to prepare to meet the specific needs of millions of Chinese tourists who will come to visit Spain.
Knowledge of management	●		<ul style="list-style-type: none"> Spanish companies' experience and knowledge in running hotel and leisure chains, in both the luxury and mass tourism tranches, should be exported to China.
Competition in Asia		●	<ul style="list-style-type: none"> It is important to analyse the competition from suppliers/operators from the Asia-Pacific region, who are very well positioned.
Coordination between companies		●	<ul style="list-style-type: none"> There needs to be an improvement in the coordination between airlines, tour-operators and hotels to make travelling from China to Spain much easier than at present.
Boom in travelling	●	●	<ul style="list-style-type: none"> Businesses and holiday travelling, both abroad and locally, will cause a boom in demand. Companies should capitalise on this opportunity to attract tourists who are "discovering the world".
Chinese tourism in Spain		●	<ul style="list-style-type: none"> Spanish service provide

● Opportunities ● Threats

4.4.3.3. Energy sector

a) Oil and infrastructures

China's growing demand for a scarce energy resource, oil, is having an impact on energy consumers around the world.

This demand is increasing not only as a result of consumption by the manufacturing industry, but also as a consequence of the growing wealth of a country of vast geographical and demographic dimensions. In coming years, then, it is anticipated that there will be an upward pressure on the price of oil, which could rise to 100 dollars a barrel, and consequently, an increase in transport costs. This situation will affect all sectors of the world economy.

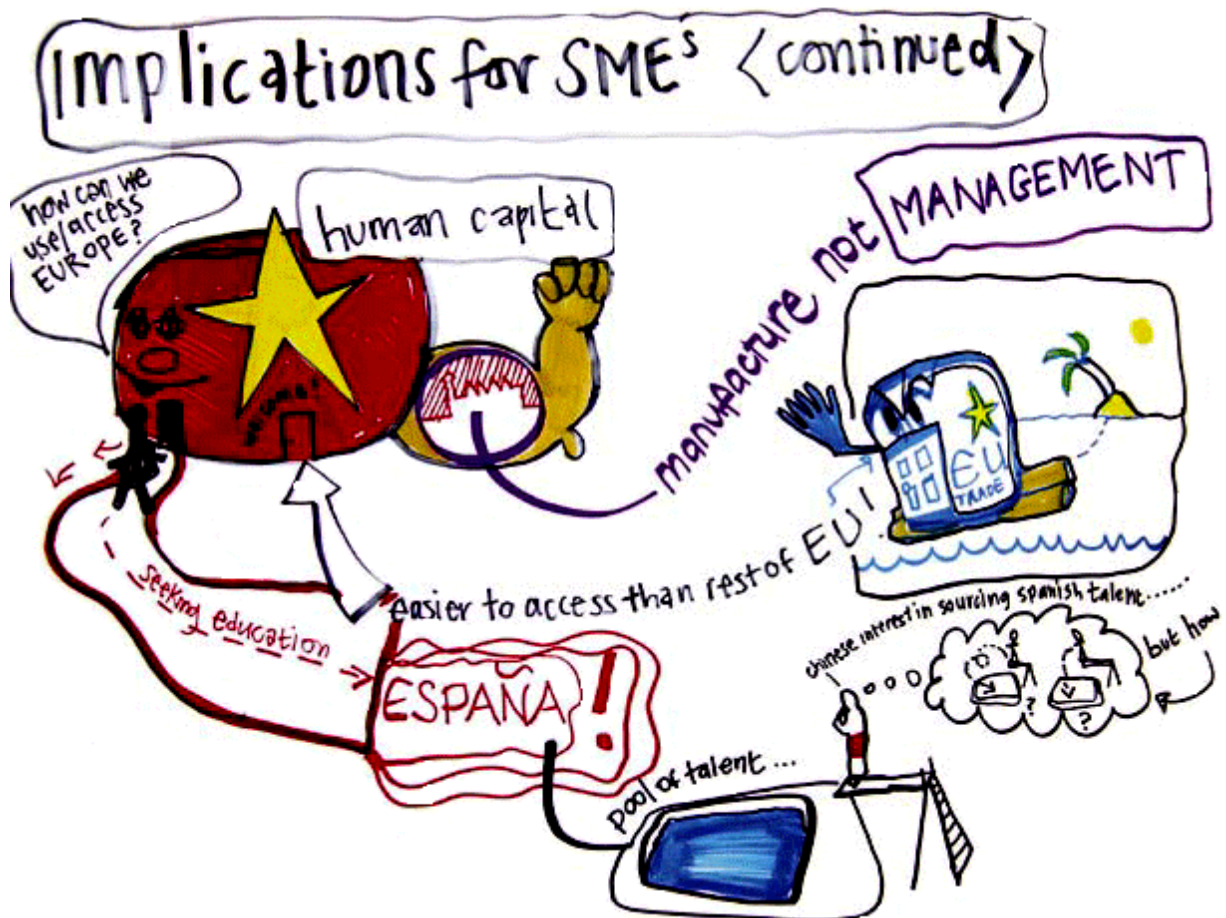
The problems of a shortfall in energy have led to a response from the Chinese government, which is making major investments to ensure its supply of oil and other sources of energy. This might represent an opportunity for Spanish companies, which could participate in infrastructure work, either individually or in partnership with other countries.

Oil and infrastructures.

Opportunities and Threats	SMEs in China	SMEs in Spain	Description
Increase in price of crude oil	●	●	• The price of crude oil will increase in the short/medium term due to growing Chinese demand for oil. This will impact all energy-consuming industries and affect all sectors of the economy.
Increase in transport prices	●		• The increase in the cost of transport resulting from a rise in oil prices makes production in China for export less competitive.
Investment in infrastructure	●		• Spanish SMEs could invest in developing infrastructures for other energy sources in China, possibly in collaboration with other foreign companies

● Opportunities ● Threats

Implications for SMEs 2.



Source: Fourth FTF Meeting.