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CHINA: Facing the Challenge

The keys to understand, cope with and seize the newest world power

BANKINTER FOUNDATION OF INNOVATION



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CHAPTER 1

Foreword

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Foreword



It was a great privilege for me to participate in the Fourth Future Trends Forum in June 2005, which dealt with the issue of the "Implications of the Dramatic Rise of China". As the director of the World Bank's China Programme, I was a privileged witness to a transformation which will have a decisive influence on the world economy and its geo-political balance. The Fundación de la Innovación **Bankinter** deserves my most sincere congratulations for having organised a dynamic session, at which, through creative thinking, risks, opportunities and probabilities were considered, within a framework of application encompassing more areas of interest than are normally tackled.

In the late 1970s, Deng Xiaoping took a great step forward: he decided to open China up to the outside world. Neither he nor anyone else could have realised what the global repercussions of this move would be. China has not conquered the world with a great army, but instead with its assembly plants and with the opening up of its markets. Over the last 25 years, the country has experienced a nearly two-figure annual growth rate, releasing around 500 million people from the most abject poverty (and turning them into the potential customers of a globalised world). Today it is the world's second-largest trading power, the largest recipient of direct foreign investment and the second-largest consumer of oil products. Its voracious appetite for raw materials has upset international markets: China now buys 40% of the world's cement, quarter of its aluminium and nearly a third of its iron ore.

It is also capable of operating across the technological spectrum, unlike Japan and other Asian giants of the 1980s and 1990s. China manufactures between 60% and 70% of the world's toys and bicycles, half of its microwave ovens, a third of its televisions and even some components of the Boeing 757. China is also preparing to take the long awaited leap to the summit of innovation, through agreements with pioneering software companies and agreements with large multinationals to produce hybrid cars and explore space with its made in China rockets.

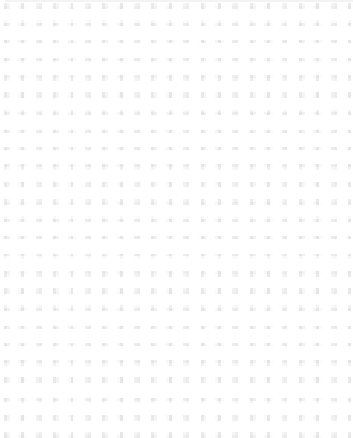
China has invaded the press, the radio and the television news: it is causing upheaval in the EU textile market, bidding for energy resources, going for companies with existing brands and attracting all the giants of the financial world to be strategic investors in its initial public offers (IPOs). There is much talk of China's immense size, but the diversity and depth of the change the country is now experiencing represent both an opportunity and a challenge: an opportunity because new production lines and processes will grow with great drive and speed, and a challenge because many of these mergers-perhaps the majority-will not endure.

The first phase of globalisation began with expeditions by European adventurers to far-off lands; the second phase was led by the multinationals and now the third phase may be born out of people and out of the initiatives of SMEs which are driving a new pyramid growth in processes and associations with their counterparts in countries such as China. The size and relative openness of the Chinese market offers a host of opportunities, but its complexities, its cultural differences and the inconsistencies of its legal system and system for protecting intellectual property may also pose serious problems for the uninitiated.

For economies like Spain's, whose trading potential lies in small and medium enterprises with a strong local presence and global aspirations, the awakening of China might be viewed as a threat. Even so, experience shows that large, rapidly-expanding diversified markets can offer more rewards than might be expected when the country in question-and this is especially true in the case of China-opens its domestic market and reinforces its export capacity without shoring it up with protective barriers. All this means that are abundant opportunities for companies prepared to forge alliances with small but dynamic local partners, who can thus get a toehold in international production networks and complement, with services of greater added value, China's greatest strength: labour-intensive product manufacture.

Because production processes are no longer vertical, economies of scale and specialisation are already available to a wide range of firms with global aspirations, something which did not occur in the past. Nonetheless, cave emptor for anyone embarking on a venture of this sort in these uncharted waters: they may make their fortune, but they might equally go to the wall. The pioneers must be prepared to invest time and resources in understanding the milieu and its risks, and to protect their own advantages in a market in a state of continuous and dramatic flux. It is against this backdrop that this book will prove so useful.

Notes



Dr. YUKON HUANG

Director of the World Bank's China Programme (1997-2004).

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CHAPTER 2

Introduction

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Introduction



The Fundación de la Innovación Bankinter analyses the best ways of facing up to the challenge of the new China

Whenever the new China is mentioned, we tend to be overcome by a combined feeling of fascination and menace, brought on by its enormous proportions, its oversized leap forward, its twin-headed role on the political and commercial stage, its recent overwhelming presence, its historical inscrutability and the weight of its remote culture and idiosyncrasy.

After two decades of spiralling economic and social growth, in which the country has gone from isolation and indifference to the forefront of the world stage, China is now, in Western eyes, much more than "the factory of the world", "the yellow giant" or "the great dragon". It is, in objective terms, the world's second largest trading power and the first destination of direct foreign investments, and it is on the verge of becoming the world's largest consumer of energy resources.

Making sense of the unknown

There can be no doubt that this situation has altered the balance and rules of many markets, thus affecting all industries. Today's China and, above all, the China that is appearing on the near horizon is seen as an enigmatic and confusing land of reward and threat; a nation which is not only benefiting from globalisation, but helping drive it forward.

It is a country which attracts large and small investors and business people from across the world, with a voracious domestic market and a surprising — even disturbing — production and distribution capacity. However, it is also a country which is actually four countries, given its huge demographic, geographical, cultural and socio-economic differences, which are tending to get wider, its democratic shortfalls, its general lack of transparency, its lukewarm environmental commitment and its disturbing political forecasts and strategies. It is a country over which too many question marks hang.

It is clear, then, that if there is something which in the near future needs to be objectively revealed, framed and examined in greater depth, it is this new Chinese situation with which, like it or not, we will have to learn to coexist from now on.

This was the conclusion reached by the members of the FTF (Future Trends Forum) when they proposed the theme for an in-depth debate at their latest meeting, organised by the **Fundación de la Innovación Bankinter**.

A long aseptic look

Two years after it was set up, the FTF has become one of the most important projects of the **Fundación de la Innovación Bankinter** and its commitment to society and the future. During that time its membership has grown from 17 to 105. Members freely propose, vote and decide on the issue which in their opinion deserves to be debated and the opinion leaders, experts from different knowledge areas, and world class scientists and international intellectuals who should take part in the meetings. Their experience and their knowledge help bring greater depth to the subject, as they seek to anticipate the immediate future-working in a timescale of three to six years-detecting social and economic trends and technological development, and analysing possible incidents in a range of areas and finally, deciding which conclusions deserve to be more widely publicised.

The success of previous editions has not only led to an increase in permanent members of the FTF, but has also underscored the value of the multidisciplinary approach, neutrality and globality which form the essential pillars of the project and which ensure the highest level of rigour, solvency and credibility for Spanish society and business, both in the forum's conclusions and in the diversity of views expressed at each meeting.

More pieces for the jigsaw

In this case, the FTF has sought to review the recent past of the new China and its dramatic changes, but also to break away from the myth, rectifying the Western vision of today's China, and also, as far as possible, setting out possible hypotheses for the future growth of the country and its market.

In this publication you will find detailed information on the real current situation of China, its macroeconomic indicators, its development expectations and plans, current international relations and agreements and possible developments in this field. The book seeks to offer a view of the country from a range of different approaches and points of view; it provides valuable keys to understanding, capitalising on and coexisting with this new great power; and it offers many new and different pieces to help solve the mental jigsaw with which we imagine the new China.

Once again the **Fundación de la Innovación Bankinter** hopes that this new publication will serve as a source of knowledge, but above all as a stimulus and guide for professionals and businesspeople from different industries who, to one extent or other, will be influenced by the emergence of the new Chinese situation in all the world's markets.

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