

Will the 'Japan model' of political economy work for China?

by Kathy Wolfe

"There is much we should learn from the Japanese experience, in which the government has played a key role in directing and guiding the economy since 1945," Feng Zhao-kui, vice director of the Institute of Japanese Studies at the Chinese Academy of Social Sciences in Beijing, told foreign journalists on Aug. 11. China should not follow the models of Reagan's United States or Thatcher's United Kingdom, he said, "They were too *laissez-faire*. Nor should we go the way of Russia, where a strict planned economy system was suddenly abolished, leading to chaos."

Feng's statement made sense, when headlines, such as "China's Boom Turning to Bust" in the Aug. 15 *Washington Post*, began to fill the western press. That which *EIR* has reported for several years is now obvious: China's physical economy has been destroyed precisely by an extreme *laissez-faire*, cheap labor policy.

While providing an "open door" to speculative slave-labor free-trade zones on the coast, Beijing shut down infrastructure and agriculture development in China's vast interior, creating a "blind flow" of peasants, now officially estimated at over 200 million unemployed, desperate to work for pennies in coastal *maquiladoras*.

The real question is, can a major policy change be effected before China explodes?

Interviews with a wide range of Japanese economists specializing in China show (at least in public), widely divergent ideas. Many Japanese seem to have caught "economic AIDS" from the yuppies in London and New York. They agree with the Wall Street view that the Communist Party's 16-point austerity plan, announced July 3, will work by "stopping inflation." "This kind of measure will not cause any bad recession in the Chinese economy," Minoru Kobayashi, executive adviser on China at the Industrial Bank of Japan, told *EIR*.

"I disagree with Professor Feng completely: The Chinese economy is very far from *laissez-faire*," said Prof. Shigeru Ishikawa at Tokyo's Aoyama Gakuin University. "Eastern Europe failed because they attempted to introduce a market economy in a big bang, whereas China is doing it gradually. China is doing pretty well in the long run, and the present difficulty is merely a cyclical phenomenon, the inevitable result of Chinese attempts to introduce a market economy.

We have to accept this. The cycle is inevitable.

"With regard to the problems of the farmers in the interior, that's a long, long-range problem to be solved—the large differentials in economic development and living standards, between the coast and the interior. This is historical and nothing can be done to remedy it.

"I think the Chinese economy is overcoming its difficulties much more skillfully than in 1988 and 1989; they are learning very well from past mistakes."

China situation 'very dangerous'

This view that a "little deflation won't hurt" millions already on the starvation line, originates with the Hongkong and Shanghai Banking Corp., whose July "Economic Report" to customers praised the Communists' deflation plan as "just the brake the [Chinese] economy needs. . . . If the plan is implemented effectively, China's economy is expected to resume more healthy and sustainable growth after a sharp—but brief—slowdown."

More traditional Japanese, usually those of the older and wiser generation who reconstructed Japan after the war, view this as economic madness. "The situation in China is very, very dangerous," Dr. Mineo Nakajima of Tokyo Foreign Language University told *EIR*.

"The western economists saying otherwise are nothing but mystics. The extreme cheap-labor policy and too much, too fast of an 'open door' policy to capital seeking cheap labor for export, has created a tremendous gap between the work force on the coast and the peasants in the interior. The new austerity measures will increase it more wildly. China is headed for extremely serious economic and social dislocations."

"Deflation is having a very bad effect on the economy, especially in the coastal areas such as Guangdong," said another Japanese economist involved in rating foreign investments. "The crime rate is zooming, Japanese tourists are warned against going there. Many Chinese officials in Guangdong are now living off drug smuggling.

"The decentralization of government in China is proceeding very rapidly, because of the huge [budget] deficit in Beijing. Many local governments are grabbing independence and acting directly to get money from foreign countries for

themselves. They even have their own foreign reserves. So the central government can't control the actions of the provinces, which are investing in whatever is speculatively profitable, such as real estate; they don't care to build factories.

"Inflow of foreign capital into China is very key to the success of the deflation policy, and that's the significance of Beijing's loss of the 2000 Olympic games. Anything that causes the amount of inflow of foreign capital to decrease is a disaster, so it's very important that China was not nominated. It shows that the foreign investment environment in China will be worse in the future and foreign money will start to flee. And they are very dependent on it. It's like a drug, you take it away, and *poof*."

Japan's 'American System'

Most Japanese economists are cautious about whether the so-called "Japan model" can work in China, given the magnitude of the current dislocations there. The most common complaint about Professor Feng's idea is that "China is too large, much larger than Japan."

However, provided a major policy change is made rapidly, there is a good possibility that the so-called Japan model will work in China—precisely because the Japan model is based on the plan under which America's first secretary of the treasury, Alexander Hamilton, first industrialized the United States, which is not exactly a small country. Hamilton's 1792 "Report on Manufactures" and "Report on a National Bank" were adopted almost verbatim by the leaders of Japan's Meiji Restoration, and were known internationally as the "American System" of political economy (see *EIR*, Jan. 3, 1992). The key to this process will be the extent to which the Beijing leadership is committed to meeting the emergency requirements for providing the investment in water, transport, and energy infrastructure that is the basis for industrialization, as Hamilton correctly noted, and also providing for the education of its population—a measure that tends to produce fear in Beijing's leaders.

Interview: Kenichi Imai

China faces stagflation followed by 'recession'

Mr. Kenichi Imai, assistant to Nobuo Maruyama, director of the Institute for Developing Economies' (IDE) Economic Cooperation Department in Tokyo, has studied the Chinese

economy in depth for years, and is personally well-acquainted with some of China's leading planners. The IDE is among the most interesting institutes in Tokyo. It does highly developed work on Third World economies, and much of the work on economic programs for the Third World for Japan's Foreign Ministry. Mr. Imai was interviewed by Kathy Wolfe on Sept. 10.

EIR: Do you think that the new Chinese "tight money" program will work? Or will it cause a bad recession?

Imai: China has a 16-point plan, issued by the [Communist] Party in July, and a seven-point plan to control investment, which was designed by the Economic Planning Commission and was authorized by the State Council at the beginning of September. The latter plan was combined with some other austerity measures, such as the general freeze of price reform during the second half of this year.

I think that the austerity measures presented in the plans will work and, as for the 16-point plan of July, it is already working. Since August, some articles reported that prices of real estate and some important materials, such as steel or timber, which had been skyrocketing since last year, turned downward. After the rise in interest rates in the middle of July, the deposits of major banks increased at a pace faster than the same period of the previous year. Growth of industrial production also started to slow in July and a further decline is projected.

The most fundamental cause of the current economic overheating is not essentially different from that of the 1988-89 overheating [which led to the 1989 Tiananmen Square demonstrations and massacre], that is, the lack of financial discipline of state-owned enterprises and local governments. In this case, what is most required to cool down the economy is a strong political will to implement unpopular austerity measures, overriding resistance from state-owned enterprises and local governments, rather than sophisticated techniques of macro-economic management. Many Chinese and foreign observers believe that Mr. Zhu Rongji, the vice prime minister who is responsible for economic matters and was also appointed as the new head of the People's Bank of China in July, can afford to exercise such an initiative.

However, success in controlling the overheated economy will not be achieved without some costs. As a result of the surge in investment last year, it is very probable that excess capacity of industry has been accumulated on a huge scale. Tight control of money will aggravate the financial burden of state-owned enterprises incurred by such excess capacity, which will weigh down enterprises and dampen their eagerness to make investments. This will further cut demand for industrial products. In this way, a fall in the growth rate of production may lead to a fall in the absolute level of production itself before long.

On the other hand, the rise in the consumer price index in major cities is still accelerating. State-owned enterprises