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 have been continuously raising payment to their employees to avoid troublesome labor disputes. Under the circumstances, they have no choice but to raise the prices of their products to cover the rising labor cost. Thus, it is probable that a slowdown of inflation will lag behind adjustment in production, as was the case with the macro-economic adjustment during 1988-90.

My conclusion is that although the recent measures will successfully brake the overheating economy, it will almost inevitably bring about a phase of stagflation which will be followed by recession. Some China specialists share this view but they seem to be optimistic about the scale and the length of the coming recession. Although I also guess that it may be milder than the one of 1989, I cannot be very sure about this point. At least I can say it heavily depends on Vice Prime Minister Zhu's personal ability.

EIR: What do you think of the ideas of Feng Zhaokui, vice director of the Institute of Japanese Studies of the Academy of Social Sciences in Beijing?

Imai: Feng Zhaokui's view that China should imitate Japan to achieve economic success is not new. Such a view appeared in the 1980s and has already become almost commonplace in China. Even the World Bank, in its report on China's economy published in 1989, presented an idea that China can learn a lesson from the initiative taken by the Ministry of International Trade and Industry (MITI) in Japan's postwar economic development process.

I basically agree with the view that in the development process of China (and of the other lesser-developed countries), the government should play a more positive role than those played by the governments of advanced countries, especially those of England and the United States, during their era of development.

In this point, I believe, Japan can provide a good example of comparably desirable intervention by the government to the market mechanism. I think it is difficult and even not very recommendable, at least at the moment, for China to imitate Japan in the central government's strong initiative in industrial development.

I point out two reasons:

1) It is a fact that the government played a relatively influential role in the development of Japan, but at the same time, it should be noted that the role played by the government remained complementary to the market mechanism. By contrast, in China the market mechanism is still unmatured. In this case, what the government should do is develop conditions without which market mechanisms cannot work effectively. Active intervention should come after that.

Moreover, there is a risk that rationality of industrial policy can be used as an excuse for sabotaging economic reform. For example, during the austerity period of 1989-90, when large and medium-scale state-owned enterprises were suffering financial trouble, Japan's so-called "Keisha-seisan-hoshiki," which gives priority to important subsectors in allocating financial resources, was cited as a rationale for bailing out those inefficient state-owned industries.

2) China's central government's ability to regulate the economy in a consistent manner is far more limited than that of Japan, and it has been further weakened as a result of deregulation. Even inside the central government you can observe many collusions of interests of each ministry, committees, and bureaus.

Last year's reorganization of the government will serve as an illustration.

Before the convening of the Eighth National People's Congress in March, it was reported in Japan that a reorganization plan of economic agencies of the central government would be approved at the Congress. The focus of the plan was to be a reorganization of the Economic and Trade Commission into a superpower economic ministry like MITI, which can exercise decisive influence on every subsector of industry and commerce. According to the plan, it was reported that the commission was to merge with the Ministry of Foreign Economic Relations and Trade, the Ministry of Commerce, the Ministry of Materials, and other ministries which are responsible for each subsector of industry. However, vested interests of the ministries were too strong to be overridden and the plan failed. The framework of economic policy which severely lacks coordination between subsectors remained almost entirely unchanged after the Congress.

I agree with you that China is now suffering from some kind of excess economic liberalism, but the nature of the liberalism is almost entirely different from Thatcherism. I point out two major differences:

1) As far as I know, one of the central policies of Mrs. Thatcher was wide-ranging privatization of the state sector. However, though China's economic liberalization showed considerable progress recently, industrial output from state-owned enterprises still amounts to nearly 50% of total industrial output. In addition to this, the [central and local] governments still interfere with the working of the economy in an extensive manner.

2) A major part of China's current economic trouble resulted from the lack of financial discipline of state-owned enterprises and local governments. So the problem should be properly described not as excess liberty but as "liberty without responsibility."

EIR: Do many Chinese economists agree with Feng's idea, that China should follow a "Japan model"?

Imai: As I have noted, advocates of the "Japan model" are not rare in China. Moreover, I think a majority of Chinese economists admit the necessity of a Japan-like industrial policy, though they do not necessarily mention Japan as a model explicitly.

However, I think there is little meaning in talking about the "possibility" of adopting Feng's idea, because the government of China has already begun introducing some parts of the "Japan model," notably so-called "strategic industrial policy," as early as the middle of the 1980s. In addition, the recent move to reorganize economic ministries is a reflection of the Chinese government's intent to follow the "Japan model."

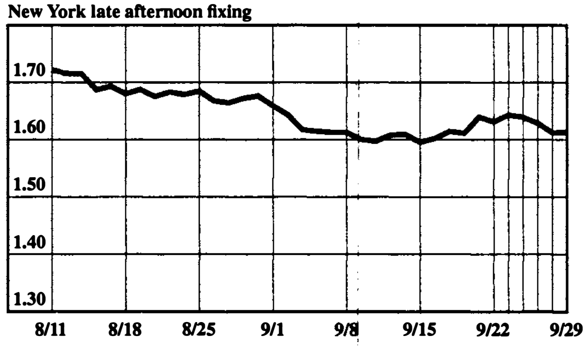
EIR: What sectors of the Chinese economy should China focus on, if they want to move to a "Japan model"?
Imai: The government started to adopt Japan-style strategic industrial policy in the 1980s. However, achievement of the policy has been rather poor to date. One reason, as many Chinese economists and bureaucrats argue, is the fact that the central government's grip on financial resources is too weak and has been attenuating further as a result of economic reform. In this context, it seems that the Chinese government is now focusing on transplanting Japan's financial system, which is highly regulated in comparison with the United States, and where semi-official financial intermediaries play significant roles in supplying long-term capital. It was reported recently that the Chinese government is planning to establish two official banks specialized in development finance and external trade by the end of this year. As you can easily see, they are imitations of the Japan Development Bank and the Export-Import Bank of Japan.

EIR: Will the Japanese government help China follow a Japanese model?
Imai: The Japanese government has been advocating a Japan-style development strategy approach in the international aid community. In this context, the Japanese government is implementing some kind of "technical cooperation" in the field of economic policy to some of Japan's aid-recipient countries. As for China, there are periodic exchanges between China's Economic and Trade Commission and MITI, and China's Economic Planning Commission and Japan's Economic Planning Agency. And, as you can see from the Chinese government's recent move to imitate Japan's framework of economic policy, it seems the exchange with MITI has been influencing the Chinese government to an unignorable extent.

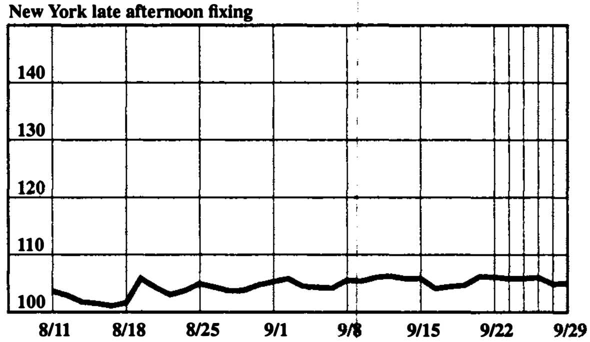
EIR: What will Japanese business do to help?
Imai: So far, the majority of Japan's direct investment to China consists of comparatively small-scale and labor-intensive industries. However, as China's orientation to a market economy becomes decisive and the Chinese market expands, more and more large-scale industries, for example, auto industries, will be willing to invest in the country. The Chinese government will welcome and encourage this trend, as it is in accord with the government's intent to promote domestic production of technology-intensive goods like automobile or electronic products.

Currency Rates

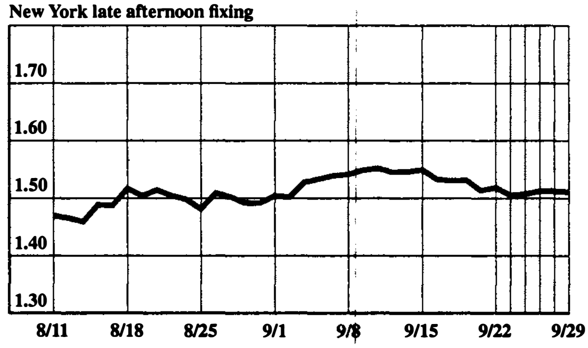
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing