

For China, high inflation not necessarily a bad thing

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PRICE ADJUSTMENTS NATURAL UNDER REFORM

BY SUSUMU YABUKI

China's economy is growing rapidly, and in fact may be overheating in certain sectors due to the boom in the real estate and stock markets and the active development of industrial zones. Real annual economic growth has topped 10% in the past several years and prices are climbing even more sharply.

Will such galloping economic growth and higher inflation have any adverse impact on the nation as a whole?

High inflation is normally said to be an unavoidable side effect to robust economic growth, but in this case it is not altogether bad. For one thing, it is attributable to a jump in prices of construction materials, sparked by active investment in factories and buildings. In the long run, such active investment will contribute to higher industrial productivity.

Second, higher prices are the result of ongoing adjustments in the nation's pricing system to seek more appropriate levels.

In the past, the prices of goods and services in China were set at artificially low levels, regardless of the costs to produce them. Thus, once the government stops setting prices for such items as crude oil, allowing them to approach international levels, it is natural that the prices of other items will change correspondingly.

Artificially low levels

Finally, we should not neglect the fact that rising prices are also being caused by growth in consumer spending. With wages, allowances and bonuses increasing, consumers have stronger purchasing power, providing strong momentum for the economy to keep expanding.

Apparently, the Beijing government believes that the way to stabilize the

nation's internal situation is to create jobs for unemployed younger people by stimulating the economy.

Where is China's economy headed? There are three broad possibilities: It can continue expanding rapidly in the coming decade, slow down due to restrictions on foreign investment or face expansion problems due to political turmoil.

Of the three, the first is most likely to occur.

If the government is successful in taming inflation, the economy could continue to expand at the current rapid pace. Today's inflationary trend is different from that of 1989 — when the government ordered the military to

clamp down on pro-democracy activists occupying Tiananmen Square, prompting many foreign companies to temporarily suspend business with China. A resultant lack of goods induced hoarding by

consumers and sent prices higher.

This time around, the situation in China is similar to the surge in prices that Japan experienced during its period of high economic growth in the early 1960s. In other words, the Chinese economy of today is in a stage where both production and consumption are beginning to show rapid growth. As such, soaring inflation is not necessarily a bad omen.

The robust growth being experienced by China will probably last for another decade. The people of China are willing to work hard to increase their incomes, giving them the ability to buy what they want. The country has high growth potential. And thanks to brisk exports, it can now afford to develop energy resources and improve its infrastructure.

However, the possibility that economic growth will be hampered by political instability cannot be ruled out completely.

Analysts believe that Beijing's recent decision to reverse course and not refund the value-added tax to foreign manufacturers reflected a conflict between the Taxation Administration and the For-

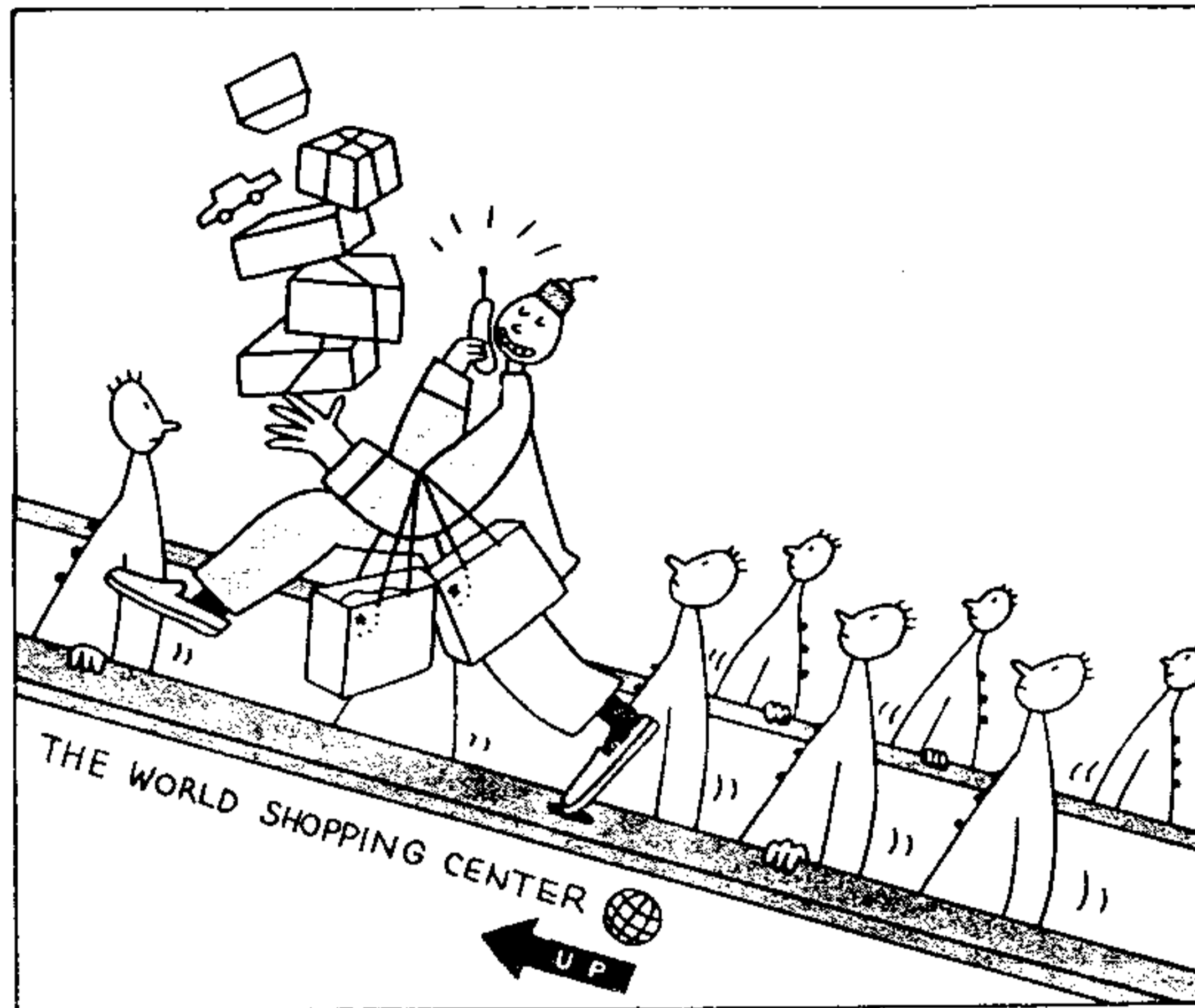


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eign Investment Administration.

Such political upheavals, if any, would not become extremely serious, because the government is keenly aware that political stability is the key to sustainable economic growth. That awareness became evident with the successful economic administration of Deng Xiaoping, who put top priority on political stability.

Government officials will take any steps deemed necessary to maintain political order. They know that the people will blame them if the country's economy deteriorates. As long as the people are enjoying economic prosperity, they will be content with the Chinese Communist Party's continued rule.

At the same time, any restrictions on foreign investment will be limited because China, although it has a plentiful supply of labor, needs foreign capi-

tal.

Even if there is a modicum of political conflict, China should still be able to attain annual economic growth of some 5%.

There are some analysts, however, who believe that political turmoil following the death of Deng will have a negative impact on the economy. Lacking a statesman who can match the charismatic Deng, the central government may prove fragile and invite instability, they say.

Environmental protection

Political issues aside, the country needs to exercise more care in the area of environmental protection by taking measures to prevent acid rain and air pollution, among other things, as it pursues economic growth.

Moreover, the widening gap in wealth between the rapidly developing coastal regions and the lagging inland regions may trigger discord among local governments.

Already, the central government and provincial government of Guangdong have been at odds over a "tax-sharing system" introduced this year that separates local taxes from national taxes. The system triggered objections from local governments, which faced a drop in tax revenues.

Even with all of the above factors, however, the possibility of political turmoil is quite low, and China's leaders can be expected to rally behind President Jiang Zemin in the name of continued prosperity.

All eyes will be focused on the 15th

Chinese Communist Party Congress in 1997, when Jiang must make his move if he is to secure his position as leader of the world's most populous country into the next century.

Even heated debates between the central government and local governments will by no means bring on military conflict. Disputes over money will be settled with money. Rural and urban areas will seek harmony through exchanges of labor and cash.

The democratization of China will develop naturally along with a rising standard of living, as it has done in other places, such as Taiwan. Overall, the economic picture looks bright for China over the next 10 years.

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