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Chinese Inflation Rate Still Tops 20%, Keeping Pressure on Nation's Leaders

By Kathy Chen

BEIJING -- Inflation in China remained stubbornly above 20% in August on an annual basis, keeping pressure on the nation's leaders to balance two sensitive goals: accelerating difficult reforms and preserving jobs.

The China Information Daily, the official newspaper of the State Statistical Bureau, said retail prices were up an estimated 20% last month from a year earlier, while consumer prices rose 22.4%. Retail and consumer prices in 35 major cities were up 21.7% and 23.7%, respectively. In July, by contrast, urban retail prices were up 24.2%, with food prices -- the most politically sensitive measure of inflation -- soaring 31.9% over July last year.

Anxious to cool China's overheated economy and bring inflation under control, Prime Minister Li Peng, along with Zhu Rongji, the vice premier and central bank governor, this week staged a remarkable television conference with local officials across the country. Mr. Li said inflation had become China's top worry and would remain so until well into 1995, the official China Daily newspaper reported.

The unprecedented video forum underscored how dire the recurrent threat of inflation is considered to be in the world's fastest-growing major economy. In recent years, a cycle has developed in which prices surge, triggering austerity policies that start to contain inflation. The policies are then relaxed, and prices leap anew.

The pattern has been in evidence since June. Sharply higher prices have reversed a slight downtrend in the first half of the year that prompted some officials to declare victory over inflation and ease credit. The result was reflected in July's fixed asset investments, which surged 72.9% from July a year ago and contributed to high inflation for that month.

The perpetual dilemma for policy makers is how to curb credit and cool upward pressure on prices without shutting down money-losing state enterprises and throwing millions out of work. If the government takes an austere line and tries to shut off its cash spigot to frail state firms, inflation may drop but social chaos could result. But if the government continues to pump out subsidies, the flood of money chasing goods will spur inflation.

The State Council, China's cabinet, already has announced a six-point antiinflation plan, including shelving reforms that would let more prices float freely, banning certain local funding of public projects and requiring local governments to meet their own inflation targets. The government also issued an urgent circular to ensure adequate, reasonably priced food supplies in major cities, ordered curbs on soaring prices for fertilizer and cotton.

The clamp down follows months of debate over whether Beijing should focus on inflation or on labor unrest, Chinese economists say. Especially since the tight-credit policy started to squeeze state-run enterprises and workers early this year, some critics argued that the government should release more funds to assuage angry workers before tackling high prices. Their stance sparked a rebuke from Mr. Zhu, who at a recent meeting criticized those who put unemployment above inflation.

"The government needs to be more effective on monetary discipline, but its credit policy will be unstable because different forces are pushing it to release credit," says Huan Guocang, a vice president at J.P. Morgan & Co. in Hong Kong.

Chief among those forces is the cash-starved state sector and its vast work force. When last year's austerity measures began to bite and some enterprises let workers go, there were protests in industrial cities such as Chongqing and Shenyang. Beijing relented and channeled funds back into the state sector.

In a sign that the government is still wary of hurting the state sector, Chinese with knowledge of the government's economic game plan say it doesn't intend to raise interest rates again this year, even though that could help offset inflationary pressure. The key reason it won't: to protect state enterprises, many of which couldn't bear the burden of higher interest repayments on their loans.

In a way, China's leadership is trapped in a terrible Catch 22. Inflation won't go away until the yawning cash maw of the state sector is closed. Yet despite an ambitious plan unveiled last year to introduce modern management to state firms, little has been done because of fears that layoffs and closures would lead to widespread worker unrest. Officials now say they will turn to the task next year, once social-security systems

are set up -- and if inflation cools.

Even Beijing's efforts to bring stability to other sectors of the economy fuel inflation. Talk of rejuvenating China's fledging stock markets by lending 10 billion yuan (US$1.16 billion) to Chinese brokerage firms, for instance, would undermine Beijing's effort to keep a tight lid on credit.

Such priorities are likely to remain under review if inflation doesn't slow. Government economists say retail prices could be as much as 18% higher this year than last, nearly double the 10% target set by Beijing.

To be sure, some inflationary pressure this year resulted from one-off policies, such as a new taxation system introduced in January and wage increases for civil servants. A wave of droughts and floods that devastated harvests also put pressure on food prices, a main component of China's inflation index.

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