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SPECIAL ★ REPORT

TIME

THE NEXT CHINA

Will Deng's heirs turn Beijing into a superpower the world can love?

DENG XIAOPING

1904-1997

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AMERICA SHOWS THE WAY

A TIME panel predicts global growth with stability led by the U.S., but warns that the good times could end abruptly without careful management

By JAY BRANEGAN

After more than five years of uninterrupted growth, analysts have taken to calling it the "Goldilocks economy"—an American expansion that is not too fast and not too slow but just right. Now, they are saying, Goldilocks may have gone global. And they can point to evidence everywhere:

►In Asia, battered Japan is back from the brink of disaster. After little growth in 1995, it last year recorded 3% growth, the fastest among the big industrial economies. Meanwhile, China, its expansion having run amuck two years ago, has managed to pull off a "soft landing" by cutting back inflation without a recession.

►Only a year ago, Latin America was still reeling from the effects of the 1994 Mexican-peso collapse. Now virtually all its major economies are riding a wave of free-market bullishness.

►In Europe, growth is perking up despite high unemployment, and there's renewed confidence that its plans to form a monetary union around the single-currency euro will be implemented on schedule in 1999.

►With Wall Street leading most of the world's stock markets outside Japan to record highs, the dollar vaulting higher, and foreign investment continuing to pour in, the U.S. is continuing to enjoy its second longest peacetime recovery. And there appears to be no end in sight.

Photographs for TIME by Gilles Leimdorfer—REA/SABA

So where's the recession? Traditional economic theory holds that every business upturn ends in a downward slide of sagging sales, declining profits and disappearing jobs. But when TIME brought together five internationally renowned experts during the World Economic Forum Meeting in Davos, Switzerland, an intriguing question floated through the clear Alpine air: Has the U.S. economy—the world's largest and most influential—banished the business cycle? Has the combination of high technology, globalized markets and unprecedented labor flexibility created a new paradigm of continual growth that can serve as a model for the rest of the planet?

The answer from TIME's experts was both yes and no. "The post-1982 American economy is significantly different from the pre-1982 one," said Robert Hormats, vice chairman of Goldman Sachs International. Since the bottom of the brutal 1982 recession, there have been but seven months of downturn. Previously, growth was interrupted on average every four years by long and deep recessions. Argued Hormats: "The business cycle hasn't been repealed, but volatility has been greatly reduced."

Does the swell of growth spreading around the world mean that the American model is contagious? TIME's experts wouldn't go that far. Although generally optimistic about the short term, most of the panel members also cautioned that the current good news could still contain the seeds of its own abrupt end.

"There's more fragility in the system than is generally recognized," warned Jeffrey Garten, dean of the Yale School of Management. "We are in a very precarious position because investors' confidence is disconnected from any hard-hitting analysis of what is underlying the economy. Even a small increase in interest rates could puncture the balloon."

Jeffrey GARTEN
Dean, Yale School of Management

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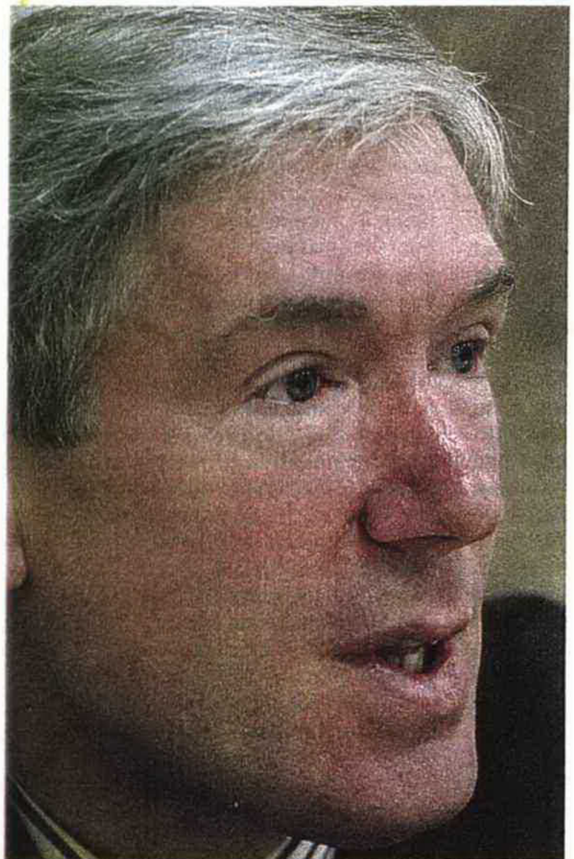


Robert HORMATS
Vice Chairman, Goldman Sachs International

"The post-1982 American economy is significantly different."

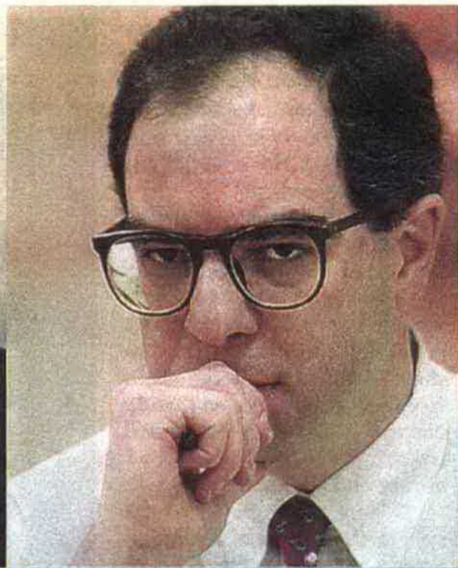
A major reason for the long surge of growth is the information revolution, which is not only creating new jobs but also helping business managers fine-tune the ups and downs of the past. "Thanks to the technological revolution, business inventories are at a 30-year low," said Hormats. This is no mere bit of arcana, he explained: "One of the major contributors to recessions in the past has been large inventory overhangs," whereby manufacturers first produce too much, letting large backlogs of unsold goods pile up in their warehouses, and then slam on the production brakes, throwing workers onto the streets.

Computer networking also enables businesses to manage their far-flung operations more efficiently, Hormats said, offering them greater ability to adapt to changing conditions. Though it may not be good news for jobholders, the new pressures of global competition are forcing managers to keep their work forces trim, thereby avoiding, as Hormats put it, "worker overhang during good times, so that in periods of weakness you don't have a gush of new workers into the jobless pool."

Join these factors with America's open trading economy and venturesome capital markets that offer ready credit to entrepreneurs, and the result is a system that can roll with the punches as never before. A corollary, Garten argued, is that the U.S. economy can grow far faster without inflation than past experience suggests—or today's Federal Reserve Board, which controls America's money supply, believes. If anything, Garten feels, the American economy is even stronger than its current performance suggests. And if it has a weakness, it may be that currency controllers won't let it grow above last year's 2.5% annual rate. He is worried that if the economy moves ahead at a faster rate than that, "the Fed is likely to pull the trigger premature-

Anders **ASLUND**
Senior Associate, Carnegie Endowment for International Peace

“Anyone who wants to make a fortune in Russia can do so.”



Luis **RUBIO**
President, Center of Research for Development

“The first era of reform is over in Latin America.”

Albert **BRESSAND**
Managing Director, Prométhee

“Barring an act of God, the euro will be in place on time.”

ly,” needlessly raising interest rates to fight a nonexistent threat of rising prices.

Some things have not changed, however: America still has a dismal savings rate and remains a huge overseas borrower. That in turn could prove to be a vulnerability. Kenneth Courtis, chief economist and strategist for Deutsche Bank Group in Tokyo, said a surging U.S. trade deficit, thanks to the mighty dollar, could ultimately spark a stampede of foreign investors from the American bond market, which would send interest rates soaring and the economy tumbling. “Those contradictions could blow up at any time,” Courtis said. “If you're talking about the stability of the international economy with the U.S. at its core, the yellow light is already flashing very strongly.”

Despite the current American success, there was no agreement among the panelists that the new U.S. economy—especially its easy-hire, easy-fire labor laws and low-cost but flimsy social safety net—will quickly be copied elsewhere. “In many countries there is a political and social drive not to accept the U.S. model in an unvarnished way,” Garten said. In fact, said Albert Bressand, head of Prométhee, a Paris think tank, the U.S. mantra of flexibility becomes the unspeakable *F* word in much of Europe: “Politically, it is now a term you cannot use. You have to dissociate yourself from it.”

All around the world, the panel cautioned, the Goldilocks economy is not always as lustrous as it appears. China, its treasury bursting with foreign reserves and its stock markets surging, is poised for stable growth, Courtis said. “And if China moves ahead an inch, the rest of Asia moves ahead a foot. We're going to have a very strong year from Beijing to Bombay.” But China's July 1 takeover of Hong Kong could still pose a problem. Courtis optimistically declared that even though Hong Kong's physical and business environment will become more polluted and “the people will be less free,” nonetheless, “the goose will get used to a different diet and still lay golden eggs.” Garten was not so sure: “The viability of Hong Kong as a financial center depends on an elusive sense of international confidence that could be lost. This relationship between Hong Kong and China will be a roller coaster.”

In India, unlike China, Courtis said, the free-market reforms pushed by the political élites have not yet won acceptance by the population at large: “They're still at the point where they think reform is going to make their life worse.” The big question mark, said the panelists, is whether the current 13-party coalition government can accelerate the pace of reform enough to attract badly needed foreign capital.

Japan, where massive government spending programs have brought the economy “back from the lip of meltdown,” said Courtis, is a study in contrasts. “The multinational manufacturers are today stronger than they've ever been,” thanks to the weak yen (currently trading at 124 to the U.S. dollar). But “small and mid-sized Japan is going through a brutal rationalization.” In four years, Courtis predicted, “we'll see 10% of GDP wiped out through liquidation of these companies.” The big question is whether a new tax program announced by the government—equivalent to a whopping 2% of GDP—is too strong a medicine. If not, said Courtis, “in six to nine months there will be a dramatic turnaround in the Japanese trade position, the export sector will grow, and investors will see the budget deficit getting much bigger.” But Courtis warned the plan could backfire: “The Japan problem isn't over. If they raise taxes too much, the economy is going to crater.”

In the European Union, the promise of growth and the fear of stagnation are now linked to the notion of a single Continental currency, the euro. Bressand predicted that, “barring an act of God, the euro will be in place on time,” in 1999. Defying conventional wisdom, he forecast that nine or 10 initial countries, including Spain and Italy, would adopt the new standard, to be joined shortly thereafter by two or three others, including current holdout Britain. The peripheral members of the E.U., he observed, have worked harder at cutting their budgets in order to meet the Maastricht Treaty's criteria for joining the currency union than have the E.U.'s two sluggish core members, France and Germany. The danger will come if the E.U. is lulled by the success of the euro into postponing badly needed structural reforms. As an insurance policy against that, Bressand argued, Europe should use the advent of the euro as a springboard to speed the entry of new members from Eastern Europe: "When we have this double success of the euro and enlargement, reform of the welfare state will be almost inevitable." Other panelists were more skeptical. Courtis gibed that Europe's heavy-handed labor regulations make it "an economic crime to give someone a job," contributing to Europe's 11% jobless rate, while Anders Aslund, a senior associate at the Carnegie Endowment for International Peace in Washington, said the experience of his native Sweden shows "the system will not allow welfare reform."

Aslund spied similar tendencies in Poland, Hungary and the Czech Republic, where tax collections equal half of gross domestic product. "They are becoming premature Western welfare states," he said, "getting stagnant, stuck in the entitlements trap and no longer doing serious reforms," while chronic laggards Romania and Bulgaria "are in a total mess." As for Russia, it has become at once stable and stagnant, Aslund argued, owing to the nonexistent reform agenda of Prime Minister Victor Chernomyrdin. "He has no vision, no strategy, nothing—and he has his ideal government where every minister is weaker than himself." In the meantime, GDP fell 6% last year, and 75% of Russian workers are not getting paid because "managers prefer to steal from the workers," yet surprisingly, this seems to pose little risk of social upheaval. The reason, according to Aslund: "Anybody who wants to make a fortune in Russia can do so. It's pretty much like the U.S. used to be in the 1890s." Or as Courtis put it, "Marxism has produced the kind of capitalism Marx wrote about."

Kenneth COURTIS
Strategist, Deutsche Bank, Tokyo

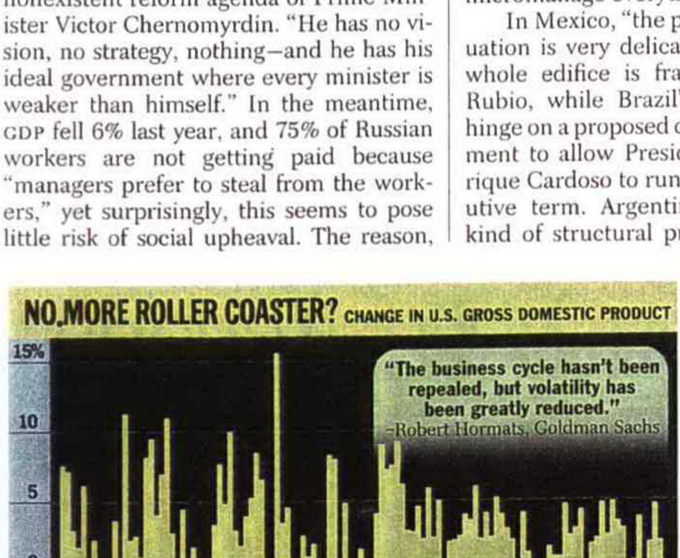
"If China moves ahead an inch, the rest of Asia moves ahead a foot."

Only recently considered a basket case, Latin America seems to be blessed with strong growth, relatively low inflation and open markets. But that reflects past reforms made by politically bold leaders, said Luis Rubio, president of Mexico's Center of Research and Development. Today, he said, "that first era of reform is over. I don't see a single important reformer in Latin America." Not unlike the situation in India, the public sees few benefits from the impressive modernization in key countries like Mexico, Brazil and Argentina, as unemployment remains stubbornly high and real wages fall. Warned Rubio: "It's a pocketbook issue, and the pocketbook is getting emptier by the day." With the spirit of deregulation on the wane, the region is vulnerable to a renewed outbreak of what Rubio called "the Latin American disease, the tendency of politicians and bureaucrats to micromanage everything."

In Mexico, "the political situation is very delicate and the whole edifice is fragile," said Rubio, while Brazil's fortunes hinge on a proposed constitutional amendment to allow President Fernando Henrique Cardoso to run for a second consecutive term. Argentina faces a different kind of structural problem, Garten said: "They have a high-wage economy and 18% unemployment. The country is importing massive amounts of equipment to substitute for labor, but there's no scenario to retrain the workers. That's going to create real political tensions."

A danger lurking beneath the surface for most Latin countries is their dependence on "hot" foreign money, unlike Asia, where outsiders are building factories and growth is financed out of high domestic savings. The problem: "An increase in U.S. interest rates would suck money right out of Latin America," Garten warned, "and create Mexican-style problems for all the major countries."

The good news for Latin America and for much of the rest of the globe is that the new, stable American economy seems to offer a strong foundation for growth elsewhere. That should continue as long as business executives and economic policymakers keep the Goldilocks economy from going too fast, which would raise interest rates, or slowing down too much, risking recession. The goal is to make it just right. Although Americans themselves would be the first to feel the consequences of any missteps, one of the lessons of today's globalized economy is that, unlike the fairy tale, everybody's at risk from the bears in the forest. *—With reporting by Thomas Sancton and Anthony Spaeth/Davos*



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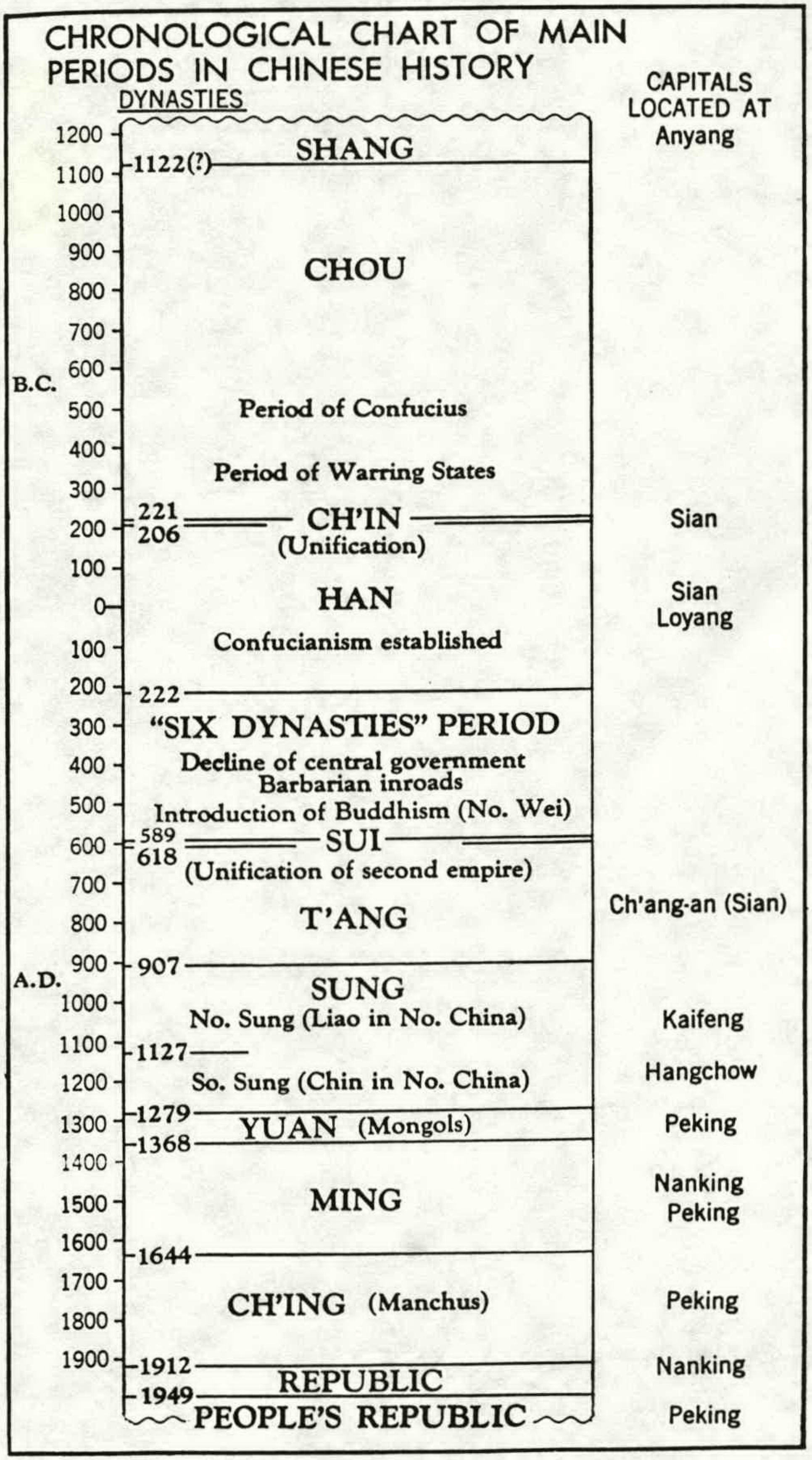

COMPARATIVE PREFERRED VALUES

	CHINESE PEASANT SOCIETY	MODERN TECHNOLOGICAL SOCIETY
KNOWLEDGE:	PRACTICAL AND CUSTOMARY	SCIENTIFIC AND CRITICAL
ASSOCIATIONS:	PERSONAL AND EMOTIONAL	ABSTRACT AND CATEGORIZED
SOCIAL ORIENTATION:	CO-OPERATIVE (WE-NESS)	COMPETITIVE (I-NESS)
LEADERSHIP:	PERSONAL	INSTITUTIONAL
LIFE GOALS:	SETTLED AND ACCEPTED	UNSETTLED AND QUESTIONED