'Invisible hand' grabs billions from China's banking system

by Cho Wen-pin

Lately in China, scandals alleging that banking executives siphoned off billions in state funds have been reported repeatedly by western news media, with each reported embezzlement bigger than the last. Headlines such as "Biggest Banking Scandal in History," "Worst Credit Fraud since 1949, for Countries Involved," or "US $28 Billion Stolen, Largest Ever," dominated the coverage.

Indeed, financial crimes exist in every corner of the country, with cadres up to the rank of vice minister involved. In the first half of this year, officials said that more than 21,000 cases of smuggling, counterfeiting, and fraud had been solved.

China's banking system is half-reformed, argue western bankers and more than a few from Hong Kong. So, they suggest, now is the time to implement a final "chop therapy" (an alternative to the stinky "shock therapy")-type reform to eliminate the loopholes, as measures complementary to the Communist Party's version of "chop therapy" which is currently chopping off the heads of those who get caught stealing money from the state banks.

However, such financial crimes happen because, after the Communists took power in 1949 and wiped out all social institutions holding a different ideology, the Chinese moral system degenerated to the historically low level which tolerated cannibalism during the Cultural Revolution. Second, as the power and health of senior leaders decline, the younger generation is grabbing money and preparing for the coming political calamity which will result from the economic chaos and struggle for power. Third, the moral vacuum as a result of the Cultural Revolution is evidenced in the rampant lust for money and carnal pleasure to be obtained by any means possible.

Zho Rongji, senior vice prime minister, is being pushed by leaders of various factions to control the chaos, and he is desperately looking for ideas for such an unprecedented task. According to the Hong Kong newspaper *Lien Ho Pao,* Zhu has told the Politburo that he is prepared to step down if the current reform and consolidation fail.

Monks talk

Nevertheless, it is almost certain that Zhu will fail, if he follows the prescription that foreign bankers and economists (he calls them "foreign monks") suggest. Those are the same advisers who aggravated the economic crises in Ibero-America and eastern Europe.

These financiers and economists may tell Zhu at the moment that the central bank should act independently to control money supply, balance sheets, and interest rates. They feed Zhu deceptive views straight from the textbooks of the Chicago school of economics, which is responsible for the accelerating downfall of the economy of the West. The World Bank and the International Monetary Fund (IMF) are advising Zhu to borrow from foreign countries, or to lease land to them to generate revenue. They never suggest, of course, issuing credit for key national infrastructure projects such as transportation, water management, and energy supply, along the lines proposed by Alexander Hamilton. They believe that credit for investment has caused China's economy's propensity for wild up-and-down swings. In the Aug. 29 *Washington Post,* economist Paul Blustein said, "Chinese bankers do not lend money based on whether a project appears to offer a good chance of repayment with interest."

In the Aug. 25 London *Financial Times,* Alexander Nicoll wrote that Beijing has been "on the World Bank's path to cooling the economy." By informing the readers that the Japanese had just extended more loans to China, Nicoll hints that Beijing now has a handle on the financial crisis, and that they should thank the international financial organizations like the World Bank and Citibank, which recently opened the first foreign bank headquarters in Shanghai. With unbridled corruption among the ranking Chinese executives, this opening for western banks would pave a legal path for capital flight.

Furthermore, the IMF and western news media such as the London *Financial Times* participated in starting the fire which is burning up the local economy. It was the *Financial Times,* in the beginning of this year, that nominated Deng Xiaoping for "Man of the Year" for 1992, for his marching orders for a free market economy. In May, the IMF used a revised Purchase Power Parity (PPP) (a method of econometrics) to miraculously rate China the third largest economy in the world. The World Bank also raised its rating on China's economy.

Only a couple of months after Zhu kicked off the 16-point austerity program to stabilize the bubble economy, the World Bank declared victory and claimed credit for directing Zhu toward a soft landing, i.e., reliance on the IMF. But the future of this fantasy is U.S.-Hong Kong dollarization, which inches in daily throughout southern China.

Yuan flies with the dollar

Next May, the Bank of China will issue its first Hong Kong dollars, replacing Hongkong and Shanghai Banking Corp. and Standard Chartered Bank as the banks of issue. The idea, as a policy announced by the Bank of China a month ago, is to use the Hong Kong dollar as a substitute for a freely convertible yuan, as demanded by the traders in Hong Kong, New York, and London.

Here is how the future looks as China's economy is operated under this two-tier system: The Bank of China and the rest of the banks that deal in dollars, on one hand, feed financiers in the British colony with Hong Kong dollars, through free trade with western countries who want to buy cheap in China; meanwhile the People's Bank of China and other banks keep injecting cheap capital to the banks dealing with dollars, by investing in yuan through the newly established Import and Export Bank, offering trade credits, export credit insurance, and project finance "to give a strong push to China's trade expansion," as one Chinese banking official put it.

So when unemployed peasants work seven days a week in the manufacturing firms which receive yuan investment from the People's Bank of China to produce tennis sneakers for export, they earn dollars that partially come back into the Bank of China. The other part stays in Hong Kong as merchants' profit and Chinese cadres' kickbacks.

According to Bank of China Vice Chairman Huang Diyan, the 360 branches of the banking group in Hong Kong and Macao already have assets of more than HK $600 billion (US $77 billion), about half of the bank's total assets, making it the second official currency.

Due to the Hong Kong-dollarization of southern China, real estate speculators are able to borrow from Hong Kong groups which may be front companies registered in China. Thus, the government's plans for financial centralization, typified by the recent banking overhaul, would have little effect on these companies that are equipped with Hong Kong dollars. The fact that investment in Guangdong province was only slightly slowed down by the austerity control program in 1988 and again today, proves the point. By as early as the beginning of this year, about one-quarter of Hong Kong dollar bills (pegged at 7.7 to the U.S. dollar) were circulating in China. That is estimated at about $20 billion worth. At least half of that stays in Guangdong, pumping up the speculative bubble.

As a challenge to Deng Xiaoping's black cat-white cat pragmatism, Beijing's hard-line economist Chen Yun has a "bird cage" theory, which asserts that the economy is like a bird: It dies if you hold it too tight, yet it flies away if you release control. The bird needs to stay in a cage, his theory concludes. Now, to his surprise, when China's economy is shouldered by the "southern wind" (the Hong Kong dollars), part of the country flies away.

So it is an irritating story to Zhu Rongji that the small Guangdong city of Nanhai could use its municipally owned assembly lines to earn Hong Kong dollars and to build a $491 million office tower in the British colony. The city then borrows against it for real estate projects back home. Beijing couldn't even get a whiff of the cash.

The Hong Kong dollar (money free from Beijing's control) not only contributes to the economic chaos in Guangdong province, but it also fuels the splitting apart of China, which is the last thing Beijing hard-liners want to see. So far, there have been nine rounds of fruitless talks between Beijing and London over a political reform in the colony proposed by Gov. Chris Patten. From the lessons China learned in the Opium Wars and the Sino-India war caused by the British government, and for the sake of Taiwan's return, it appears that at least a few Politburo members in Beijing have decided against the proposal from London, which would turn Hong Kong into a giant enterprise in which Britain acts like a CEO, leaving Beijing only the ownership as chairman of the board.

Bank of China may bankrupt China

But all the fights with the British government over controlling Hong Kong mean nothing if the Bank of China gives up its stance on controlling Hong Kong dollars, allowing part of China to become U.S.-Hong Kong dollarized. In this sense, the Bank of China will bankrupt China. And this is the destiny which some of Zhu's foreign advisers are leading him to.

Zhu is reportedly orchestrating four groups of economists and other experts in Baidaihe in northern China to draft the final plans to reform banking, financial revenue, investment, and state assets management systems. Plans are to be approved in the Third Plenary Session of the 14th Communist Party Central Committee, scheduled in mid-December in Beijing. If passed, the plans are to be fully implemented nationwide in 1994, as the final stage of the fight to implement the reforms, as proposed by Chen Yun, among others, to safeguard the system of a planned economy.

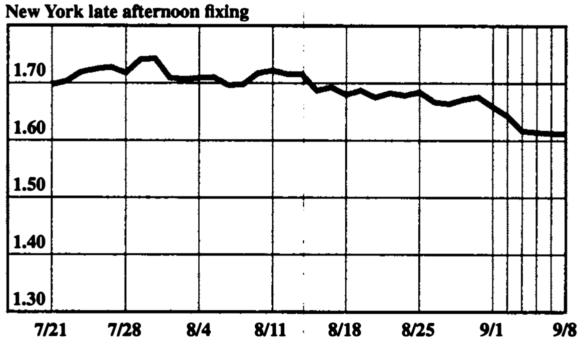
If Beijing is not highly alert to the U.S.-Hong Kong dollarization while reforming the banking system, which is necessary to control localism and prevent the investment craze in real estate and other speculative activities, then not only will China fail due to the lack of commitment to develop its physical economy, but it will sink with the western monetary system that is doomed to collapse, even before any real development begins.

The situation could best be described by a Chinese proverb: "The mantis stalks the cicada, unaware of the oriole behind." That danger is precisely the U.S.-Hong Kong dollarization, wherein hide the immoral sharks such as George Soros, who recently made $1 billion in one week of speculation against the European Exchange Rate Mechanism.

Currency Rates

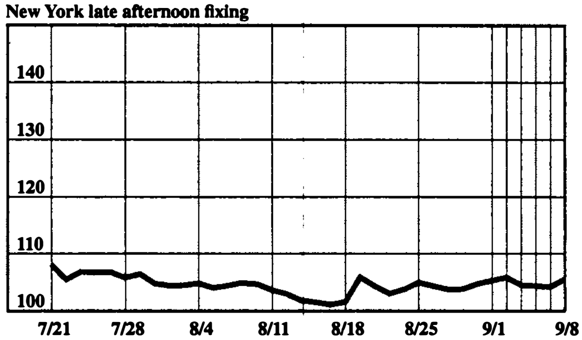
The dollar in deutschemarks

New York late afternoon fixing



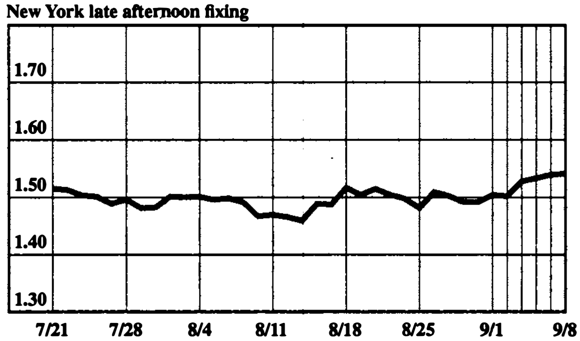
The dollar in yen

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