China

Foreign speculators have a 'screw loose'

by Mary Burdman

Since the warning by Chinese Prime Minister Li Peng on Nov. 21 of the possibility of a new "Black Friday" financial crash, more Chinese leaders have spoken about the dangerous state of the current world financial system. Officials are now taking steps to stop derivatives speculation, in order to curb the powers of the City of London and Wall Street in China. Such moves as a threat by leading Chinese firms to counter-sue Lehman Brothers, one of the most important New York investment banks, represent a real danger to the financial house of cards.

In mid-November, Lehman Brothers sued China's three largest trading companies for $100 million, after having been, as a Lehman official elegantly put it, "stiffed" by the companies for debts run up in foreign exchange and swap trading under Lehman's guidance. But on Dec. 21, Cao Yongfang, president of a subsidiary of the state-backed China National Metals and Minerals Import-Export Corp. (Minmetals), one of the firms, denounced Lehman Brothers' "improper and unfair marketing, trading, and investment advisory serivces." Cao announced that he had asked a Hongkong branch of a New York law firm to prepare a counter-suit. "We intend to respond vigorously to Lehman's claims, which we believe are entirely without merit. . . . We have instructed our attorneys to investigate all aspects of Lehman's dealings with our companies in order to pursue counterclaims."

Minmetals' counterclaims could top Lehman's claims by "tens of millions" of dollars, the Chinese company's lawyers said. The law firm Kaye, Scholer specializes in litigation involving derivatives. The lawyers said that Lehman's had "lured a young and inexperienced employee" into making trades he was not authorized to conduct, through an offshore bank account set up at Lehman Brothers. The employee, then 31 years old, was granted a higher trading limit than the Bank of China! The employee carried out foreign exchange trades over two years, although permission to carry out such trades had been explicitly refused by Minmetal's president, the lawyers said. Over the period, Lehman's "lured this young employee with progressively more inappropriate trades, wholly unrelated to the type of proper hedging that would be permitted under Minmetals' scope of business."

Unipec, a Chinese oil trading company, has accused Lehman's of initiating a publicity campaign to recover losses caused by its "failure to employ due diligence in the conduct of its business."

Other Chinese institutions are also not mincing words. A spokesman of the national China International Trust and Investment Corp. confirmed on Dec. 18 that while CITIC is committed to a "reasonable solution" to the dispute between its Shanghai branch and creditors on the London Metals Exchange, the international speculators are themselves to blame for their losses of at least $40 million. In an interview with the official *China Daily Business Weekly* on Dec. 18, Xu Shiwei, the senior adviser to CITIC Shanghai, said, "I must regretfully point out, that certain foreign counterparts have got some screw loose in their own house. In other words, what they have done has to some extent assisted such a thing happening, unintentionally or intentionally."

Xu said that credit had been extended to the Shanghai CITIC branch equivalent to five or six times their equity, without notifying CITIC national headquarters or requiring any guarantee from CITIC. "Any counterpart, if he is prudent enough, should have related extension of credit to CITIC Shanghai's capacity, and in line with China's relevant laws and regulations governing foreign exchange," Xu said. He stated that four employees of the Shanghai CITIC branch, including its former head, have been detained on charges of corruption and illegal trading.

In the same *China Daily,* Liu Zhiben, director general of the Foreign Trade and Economic Cooperation Ministry, attacked reports in the western press demanding that the Chinese government pay for speculative losses. Liu said that the "flimsy linkage of corporate disputes to the government's credibility is a thinly veiled attempt to mar the image of China as an investment magnet."

The government is not responsible

"Some investors," Liu said, "are fond of the idea that doing business with Chinese state-owned companies means gaining a secure link with the Chinese government—a link that could come in handy if the state-owned Chinese investment partner suffers losses. But the reality of the arrangement is different. For many years, Chinese enterprises, whether state, collectively owned, or privately owned, have had to sink or swim on their own. The days of rigid central planning and responsibility for state firms has gone."

London and Wall Street are also playing hardball. On Dec. 16, the *Wall Street Journal* reported that "foreign banks intend to curb lending . . . until three Chinese companies accused by foreign banks of defaulting on about $140 million in losses incurred on overseas exchanges settle with their creditors." China, the world's 11th-largest trading nation, could "suffer serious losses from price changes and currency fluctuations."

However, one analyst said, "The People's Bank is not altogether unhappy about the situation. . . . They've been trying to shut down a lot of this [speculative] activity, and now the market is doing it for them."