China is preparing for financial 'danger in times of peace'

by Mary Burdman

The leaders of China met at the very highest level at a Central Financial Work Conference in Beijing on Nov. 17-19, 1997. The purpose of the meeting was to ready China to meet "danger in times of peace," in the face of the financial crisis sweeping East and Southeast Asia. The conference was called and led by both the Central Committee of China's Communist Party, and the State Council, which is unprecedented for such a work conference on the financial situation. China's top leaders all addressed the meeting, which was attended by national, provincial, and municipal-level leaders.

China's fundamentally sound economic development since 1978, and especially in recent years, has furnished protection, so far, from the financial disasters hitting the rest of Asia. This growth has been based on infrastructure construction; gradual, relatively controlled economic and financial reform; and the continued limited convertibility of its currency—the renminbi is convertible only on current, but not capital accounts.

That protection, however, is limited. China itself has a serious internal bad debt, the result of the state banking system acting as the government's "teller," supplying direct cash, rather than repayable credit, to the state-owned enterprises. In addition, the deep economic crises in Southeast Asia, South Korea, and Japan, and the generally massive devaluation of other Asian currencies, will hit China's export markets hard. At the same time, many of China's development plans are, currently, conceived of as being dependent on foreign investment, which will clearly be limited in the current situation. China has also become one of the biggest holders of foreign capital, another vulnerability to international financial turmoil.

Most important, however, is the risk to China's real economy. As the Hong Kong newspaper *Wen Wei Po,* which reflects national policy, stated in an editorial on Nov. 18: "The biggest problem behind the financial turbulence in Southeast Asian countries and regions is closely connected to the economic structure. This sends a warning signal to China, whose irrational economic structure is becoming an increasingly outstanding problem. Therefore, while strengthening financial supervision, China should put an end to repetitive development, substantively strengthen the structural adjustment, and ensure the healthy and benign development of the national economy. This is a long-term strategy for guarding against financial risks."

President Jiang Zemin put it most succinctly. At the Dec. 15-16 informal Asian summit in Kuala Lumpur, he said, during a discussion with Singapore's Prime Minister Goh Chok Tong: "The reason behind the financial turbulence is complex. We understand the difficulties some countries are facing. The financial turbulence has taught us a lesson: Economic security should cover financial security, and, while a country is opening up, it needs to maintain its own rational economic structure and coordinated development of infrastructure and manufacturing. We have confidence in the future of the economy in Asia."

Reflecting the discussions in Beijing, and China's resolution to take measures, Jiang Zemin said in his speech to the summit on Dec. 15, that the Asian crisis had taught "a profound lesson." East Asian nations can "set a model for economic cooperation among countries and regions in the world," and "also play an important role in promoting the establishment of a just and rational new international political and economic order of peace and stability," he said. But, even while recognizing these economic achievements, "we must also look squarely into the difficulties and obstacles on the way ahead. . . . Southeast Asia's financial turmoil in recent months has taught people a profound lesson. Normal functioning of the financial system is crucial to the overall economic stability and development. To maintain a sound and stable financial order in a closely intertwined global economy, it is imperative for countries to work to improve their financial system, policy, and supervision, strengthen both regional and international financial cooperation, and jointly ward off excessive speculation by international hot money. Only by so doing can we effectively maintain the international financial order. Today there is a greater need to strengthen financial cooperation in East Asia. China has taken a positive approach toward it and is ready to take part in relevant discussions."

Straightening out the financial order

A Russian observer recently noted, during a discussion in Germany, the difference between the humility of the leadership of China, who openly state that their nation has only begun its economic reconstruction, and the foolish arrogance of other governments, particularly in the former Soviet Union and eastern Europe, who refuse to even acknowledge the massive crisis already engulfing them. The remarkable speech by Czech

President Vaclav Havel on Dec. 9, is a notable exception.

So it was at the Beijing financial meeting. This working conference, which was followed the next week by a top-level meeting called by the People's Bank of China, was addressed by President and CP head Jiang Zemin, Prime Minister Li Peng, and Executive Vice Premier Zhu Rongji. The leading members of the Party Central Committee and the State Council attended, as well as provincial governors, regional and municipal heads, vice governors in charge of financial work, heads of the relevant party and State Council departments, governors and vice governors of state banks and key branches, governors of provincial branches of the People's Bank of China, and persons in charge of insurance companies and large financial institutions.

Already on the eve of the World Bank annual conference in Hong Kong in September, Zhu Rongji announced that China would call a central financial conference in Beijing in November, because of the threat to China's overall stability.

At the conference, according to several Chinese press accounts, Jiang Zemin warned that China is facing new issues, with no foreign example to copy. Should a "financial storm" be triggered, or should an error lead to a financial crisis, all of China's reform and development would be hit, and this would also lead to social difficulties. Furthermore, China cannot expect foreign aid should a financial crisis take place; in this situation, it is imperative to be prepared for danger in times of peace and take precautions against possible difficulties. The Chinese President said that it was "imperative" to draw lessons from the financial crises occurring in some Asian countries, review the hidden problems in China's financial arena, and take measures to resolve them.

Zhu Rongji, responsible for China's economy, said that the chief causes of the Southeast Asian financial crises lie in problems in control and supervision. China has both these problems, he said, and warned of the danger that some Chinese leaders are too incautious, and too ambitious. "Localism" and "departmentalism" are interfering with implementation of the financial policies of the central government. In the current situation, failures of discipline, and any illusions that there is the "freedom" to violate laws and regulations, constitute serious dangers, Zhu warned. He also chided government departments for failure to strictly adhere to policies, a situation which can no longer be accepted.

"Straightening out the financial order" and financial reform have been made a priority, in the wake of the Sept. 15 National Party Congress, *Peoples Daily,* China's newspaper of record, stated in an editorial on Nov. 20. "This is a major policy decision and strategic measure adopted after taking the overall situation into consideration and sizing up the times." The purpose of the conference was "to establish a sound modern financial structure and system; standardize and institutionalize all financial activities; notably improve the standards in managing, monitoring, and supervising the financial industry; effectively prevent and reduce financial risks; and guide the financial industry in the direction of healthy development so that it can better serve reform, opening up, and modernization." China will try to do this over the next three years.

A Xinhua official broadcast the same day reported that the conference had concluded that "it is imperative to . . . run banks really as banks, strengthen the financial supervision and management functions of the People's Bank, quicken the commercialization of state commercial banks," and "put all financial activities on the track of standardization and legalization." At the same time, "it is imperative to . . . create a favorable economic environment for a benign financial cycle, and in particular, speed up the reform of state-owned enterprises, and establish an investment structure in which government administration is separated from enterprise management."

China's banking system is a key issue of concern. Approximately two-thirds of the capital of China's state-owned commercial banks is citizens' savings deposits (totalling about 4 trillion yuan, or $500 billion), and if these savings are not protected from the kind of banking disasters which have hit the rest of East Asia, China risks real social troubles. But China's banking system is burdened with bad debts, due to the banks' lending to the state-owned enterprises, which, be-

China Daily: LaRouche 'cautioned the world'

Economist Lyndon LaRouche "cautioned the world" on the international financial crisis, *China Daily,* China's official English-language daily, said on Dec. 9 in its lead Opinion Page article, titled "Asia Draws Lessons from Financial Crisis." Author Wei Jianing, director of the Financial Research Office with the Development Research Center of the State Council of China, wrote:

"The recent global financial turmoil that started to devastate Southest Asia this July has greatly shocked the world.

"But actually many economists, like Lyndon LaRouche, already cautioned the world several years ago against the coming of a worldwide financial crisis in the 1990s."

Wei Jianing cited Paul Krugman's book, *The Myth of Asia's Miracle,* warning of the dampened enthusiasm of the Asian "tiger" economies for the so-called "East Asian Miracle." "However," Wei Jianing wrote, "some governments neglected those warnings. . . .

"In spite of all arguments, all agree that the recent financial turmoil has drastically influenced the whole world and forced the financial world to reflect on some basic theoretical issues."

cause of their own poor efficiency, have been unable to repay.

As *Wen Wei Po* wrote on Nov. 17, "When the social and economic environment is relatively stable, such latent risks will not break out into a crisis. But when social and economic life is turbulent, such latent risks may become reality."

Non-banking financial institutions—credit cooperatives, development investment banks, trust companies—are in worse shape, badly indebted, and some are bordering on bankruptcy. The stock market bubble, though somewhat deflated, is far from eliminated. Many shares listed are of "poor quality," bringing more risks of stock market troubles.

The Beijing government has established a "Central Leading Group for Financial Work," led by Zhu Rongji, with the assistance of Vice Premier Li Lanqing, who is in charge of the financial system; CP Politburo members Wu Bangguo, responsible for state enterprise reform, and Wen Jiabao; and foreign trade minister Wu Yi.

China's vulnerability

China's leaders clearly recognize that their nation is all too vulnerable to the financial crises erupting all over the world. As *Wen Wei Po* wrote on Nov. 21, "the overseas economic crises since the 1980s have all been triggered by monetary issues, such as Japan's bubble economy, Mexico's monetary crisis, and the current monetary crisis in Southeast Asia. Hence, it is a global issue to adopt measures to guard against monetary risks. If China does not have a full set of mechanisms and methods for guarding against and mitigating the monetary risks, the effects of foreign monetary crises would exploit the advantages of the weak point to easily take their way into China and undermine China's monetary [stability] and economy as a whole."

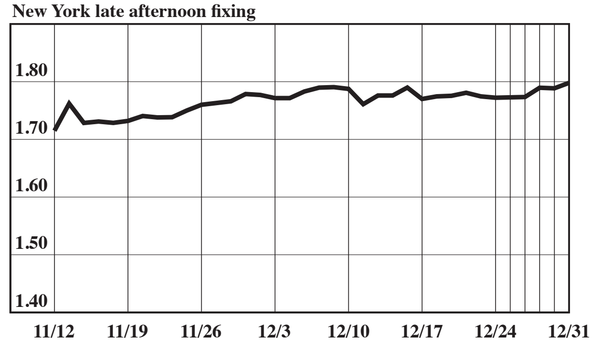
According to other press reports, a department of the State Planning Commission recently warned of the problem posed by China's "hidden foreign debt." Various methods have been used for enterprises to borrow abroad, in violation of all government policies or regulations. Such unregulated or "offshore" borrowing could well lead to China's foreign debt getting beyond knowledge and beyond control—such as has happened in the Republic of Korea.

A total of 15 measures were formulated at the financial work conference, to be enforced over the next 10 years, at least. These include tightening central bank control over regional administration, establishing a mechanism to deal centrally with bad debt, and making incursion of any further bad debt, the direct, legal responsibility of those involved. A key measure will be to clean up international speculative "hot money," and get, and keep, it out of China. The demands of the World Trade Organization, that China speed up its plans for free convertibility of the renminbi, will *not* be met. One high-ranking CPC leader was recently cited in the Hong Kong press saying that, to join the WTO, China would rather make concessions in other aspects than open up the financial market too early.

Currency Rates

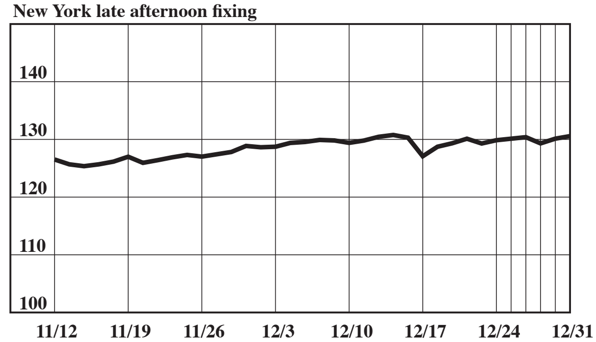
The dollar in deutschemarks

New York late afternoon fixing



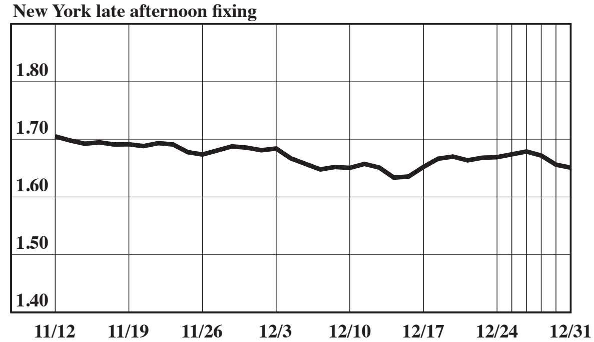
The dollar in yen

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