China's prime minister warns of new world financial crash

by Mary Burdman

Prime Minister Li Peng of China has become the first head of any government to make the danger of a new "Black Friday" financial crash a matter of open diplomacy. Li Peng met with chairman Peter Kann and the board of directors of the American Dow Jones and Co., publishers of the *Wall Street Journal,* in Beijing on Nov. 21 at Zhongnanhai, the official reception hall of China's government. When he was asked if China would make its currency convertible any time soon, Li Peng replied: "If our currency is convertible, another Black Friday crash in the U.S. would hurt China. So I do not think it [convertible currency] will happen very soon," the *Wall Street Journal Europe* reported in an exclusive article on the meeting on Nov. 22.

Li Peng's statement is the strongest indication to date, that China's leaders are committed to preserving the nation from its deadly enemy—Great Britain. Those economists and scholars who recognize the extent of the economic crisis in China, are also fully aware of the industrial and financial disaster in the "advanced" nations. The collapse of Russia and Ukraine under the weight of International Monetary Fund-dictated shock therapy was only the final proof, to one group of Chinese leaders, that the nation would have to take measures to protect China's core assets at the same time that it had to find means to build desperately needed infrastructure.

Since 1993, China has been attempting to break out of the course charted for it by London and its assets. On Sept. 26, the official *China Daily* noted that the measures taken to curb real estate speculation and increase taxes last year, had been effective. "Investment" from Hongkong, Taiwan, and Macao had declined, but U.S., European, and Japanese companies had "demonstrated greater interest in China's machinery, electronics, and chemical sectors. . . . The sharp reduction in speculative real estate projects, versus steady growth in basic industries and infrastructure, suits the Chinese government's new industrial strategy to sustain a long-term economic development."

Li Peng's statement is only one example. Beijing is also showing resistance about submission to the "free-trade" regime of the General Agreement on Tariffs and Trade (GATT), and has thrown all sorts of western speculators, hovering at the brink of bankruptcy, into a frenzy of anxiety, while throwing their Chinese assets into jail.

Many of Beijing's actions are opportunistic bargaining, which could fail utterly. But the world situation is so tenuous, that one recent commentary even warned that China's recalcitrance on free trade could bring down the entire world trading system! There is truth to this warning, despite the terrible weaknesses of the Chinese economy. A determined national leadership could collapse the international financial house of cards.

In his meeting with Dow Jones, Li Peng publicly noted other problems that China, along with other developing economies, faces. He stated that China's large borrowings from Japan, mostly from the early 1980s, were made when the yen was 360 to the dollar; now they must be repaid at nearly triple the original value in dollar terms, due to the rise in the yen to almost 100 to the dollar. Last month, the Japanese *Nihon Keizai Shimbun* reported that a group of 31 banks, of which 24 are Japanese, had petitioned Executive Prime Minister Zhu Rongji to help them recover $600 million in loans made to Chinese state industry in the early 1980s. The Japanese banks have a total of $1.8 billion in loans outstanding to China; total Japanese lending to China is in the range of $25 billion.

Li Peng also emphasized that China's stock markets were "still at a trial stage," and that the government has a "cautious attitude" toward developing these markets. He cited market scandals in China itself in 1992-93, and the more recent debacle of the MMM Joint Stock Co. in Russia, to show the fragility of the "emerging" financial markets—those markets which have been the targets of the most ruthless international speculators, including George Soros, in the past two years. The Hongkong market itself has been plunging ever since January.

Chinese officials have been stating China's differences with prevailing international policy on GATT and free trade. China had been a founder of GATT, but the communist government pulled out in 1949. Now China wants to rejoin as a founding member of the World Trade Organization in January, but U.S. Trade Representative Mickey Kantor is maintaining U.S. insistence that China enter GATT as a "developed" nation, which would eliminate all protection of its agriculture and industry. China, a nation where 75% of the 1.2 billion population are still peasants, would be destroyed in the process.

The vultures of world finance want to repeat the 19th-century "Opium War" strategy, when the British Empire, with nothing to offer the world except opium grown in conquered India, waged war to forcibly create a "market" in China. One set of shysters, typified by Bankers Trust's William Overholt, penetrated China by promoting the mirage of an economic "superpower"; another set, including *Time* magazine's Richard Hornick, now at the East-West Institute, the Trilateral Commission's think-tank in Hawaii, is promoting a "China crash," another facet of the British International Institute of Strategic Studies "divide and conquer" policy.

Frontal assault

Since mid-November, Lehman Brothers, J.P. Morgan, Merrill Lynch, Crédit Lyonnais, well publicized by the *Wall Street Journal* and London *Financial Times*, have been in a frontal assault against China. The reason? Since mid-1993, Beijing has been attempting to shift foreign investment out of dangerous speculation, which the City of London and Wall Street cannot tolerate. At the same time, China has caught international banks red-handed, luring Chinese into huge speculative operations on the markets with multimillion-dollar credit lines. The inevitable losses could drain China of desperately needed foreign exchange. Beijing has taken steps.

In June, the official *People's Daily* announced that the Chinese government will "strictly control futures trading outside its borders. . . . Blind speculation on international exchanges has led to huge outflow of foreign exchange" from China, much of it government funds. Foreigners who had already violated regulations in their home countries of the United States, Singapore, Hongkong, and Taiwan, were "taking advantage" of Beijing's still-primitive legal system to set up business in China.

The government also officially denounced China's top stock-market official Liu Hongru, for colluding with international investment banks, especially the U.S.-based Goldman Sachs and Co., Merrill Lynch and Co., and Morgan Stanley Group Inc., to list all the most profitable Chinese companies on foreign stock markets—meaning Hongkong and New York—rather than Chinese stock markets. His machinations with Wall Street left debt-laden state-run industries on the domestic stock markets, forcing them to compete with the central government for vitally needed domestic capital.

This was followed up on Nov. 7, when a government circular issued by four agencies, including the China Securities Regulatory Commission and the Ministry for Public Security, announced a crackdown on illicit futures trading of foreign exchanges. Some Chinese firms had not only conducted unsanctioned futures trading abroad, but "even did deals with [unspecified] unlawful overseas groups to defraud customers of their capital." The operations caused "financial disorder and led to a drain of foreign exchange." Both sides involved in unapproved trading will not be protected by the law, the circular states.

Lehman Brothers was the first to react, resorting to suing China's three largest trading companies for $100 million, because those companies, Lehman Brothers claims, failed to pay for debts to that amount incurred while engaging in foreign exchange and swap trading under Lehman Brothers' guidance from May to August of this year, the *Financial Times* reported on Nov. 17. China United Petroleum Chemicals (Unipec), International Non-Ferrous Metals Trading, and China National Metals and Minerals Export and Import were given 30 days to appear in U.S. court in New York to answer Lehman Brothers' claims.

In addition, the Shanghai subsidiary of the government-controlled China International Trust and Investment Corp. has reportedly defaulted on $30-50 million in obligations from futures trading on the London Metals Exchange earlier this year. CITIC headquarters has so far refused to take responsibility for the default, because the operations of the Shanghai house were unauthorized and illegal.

This has caused great consternation. If the Chinese government-controlled banks fail to pay for their losses on western exchanges, "the potential international repercussions are extremely serious," the chairman of the London Metals Exchange Raj Bagri told the *Wall Street Journal Europe* in an interview on Nov. 24. "It would be a dangerous precedent if organizations controlled by foreign governments believe that they can play on international markets and negotiate their way out of settling debts." CITIC officials say that the traders acted in violation of Chinese law by taking huge speculative "positions" on the exchange. The head of the Shanghai branch, Gao Kongliang, has been jailed for committing China in huge speculation operations in copper futures in London "in a criminal way," and two traders have also been arrested. They incurred debts worth $40 million. Gao, a former shipyard welder, launched his operations after attending a seminar on futures trading run by the Chicago Board of Trade in 1992. By the end of 1993, CITIC Shanghai had become the biggest copper-futures trader in the world, and it is estimated that, before his downfall, CITIC Shanghai had amassed nearly $700 million on the London Metals Exchange.

While maintaining that the issue of CITIC's responsibility for the debts is an issue of Chinese law, officials have reportedly offered to negotiate a settlement with London, but the offer has been rejected as "dangerous" by the exchange chairman. "If they don't settle, metals firms will become even more cautious about scrutinizing the credit of customers. The result will be a loss of business for the exchanges and for China," he said.

Zhu Rongji is "extremely angry" about the international investment banks' operations, a Chinese official told the *Wall Street Journal Europe* on Nov. 24. Zhu Rongji blames the investment banks for arranging big credit lines for the Chinese firms, and assuming that these firms were acting on behalf of Beijing. Zhu does not want to pay out precious hard currency reserves for the debts, which were incurred from speculation never approved by Beijing.

In addition to Lehman Brothers, Merrill Lynch, Goldman Sachs, Crédit Lyonnais Rouse, Prudential Bache, and others have been attacking China for "welshing" on what they estimate to be hundreds of millions in debts from Chinese firms incurred in swap and other speculative trading. As the *Wall Street Journal* quoted one "Lehman executive" in an editorial on Nov. 21, if China wants to borrow on world markets, "It can't go around stiffing people like this."

Stop infrastructure investment

In addition to lawsuits, international financiers are using China's refusal to pay as reason to limit infrastructure investment. Even Hongkong's richest financier, Li Ka-shing, who claims great friendship for China, announced on Nov. 24 at a trade seminar in Hongkong that frequently changing policies, a confused tax structure, and restricted returns on infrastructure projects are "cause for concern." Li, Beijing's liaison to the government in Hongkong, said that restrictions on the returns foreign investors can expect from infrastructure investments should be relaxed, and Li called for reform of China's legal and taxation system.

Earlier in the month, World Bank President Lewis Preston had "warned" Chinese officials that they would drive away foreign capital if they insisted on limited rates of return. Since 1992, Prime Minister Li Peng had attempted to set a cap of 12-15% on profit that foreign investors could earn, in contrast to 18-22% in other Asian nations. As a result, capital went elsewhere. China limits foreign share in strategic power plants to 30%, while keeping the grid system and other infrastructure under "unified state management."

The *Financial Times*, mouthpiece of the City of London, warned on Nov. 24: "China's rash of troubles with western creditors over unpaid debts is casting a pall over plans for heavy foreign investment in Chinese infrastructure, particularly in the power sector. Western bankers also report signs of nervousness in international debt markets over China's exposure." China's foreign debt is approaching $100 billion. The bankers were particularly not amused by Beijing's attempt to cap rates of return, something Beijing has not reversed, despite the pressure.

Make China knuckle under

China's vulnerability is its determination to become a founding member of the World Trade Organization, a desire western free traders want to exploit to the hilt, as a commentary in the *International Herald Tribune* on Nov. 18 shows. "The West must stay firm with China," it stated, and not miss its "once-only chance to propel China along the road to economic reform and induce it to become a constructive player in the world economy. It is vital that the West—and above all the United States—not let this huge prize slip away." The West must use China's "fervent ambition" to become a founding member of the WTO, to enforce on China "cast-iron commitments to open up the country's still largely centrally planned economy, the most protectionist of any major country," the commentary said. "If China is allowed to continue on its current mercantilist path, it will disrupt the world trading system and undermine plans for an Asia-Pacific free trade area by 2020," which was the conclusion of the Asia-Pacific Economic Cooperation (APEC) summit in Jakarta, Indonesia in mid-November. "Fortunately, the urgency of Beijing's desire to join the WTO gives the West enormous leverage," it said.

"The real problem is that China is still trying to evade paying the full entry price, which means accepting the capitalist free-market principles which have governed the western-dominated world trading system since World War II." But China must "not be allowed to hide behind phony claims of developing-country status," the commentary states. The *International Herald Tribune* quoted a report from the Washington Economic Strategy Institute, warning that "if China is permitted to gain the benefits of membership, while persisting with mercantilist practices, it will make a mockery of the WTO's free-trade principles and threaten the entire world trading system. Western economies could be devastated by exports from a protectionist, state-directed economy possessing enormous pools of low-cost labor."

But Beijing is also playing hardball. Chinese officials dismiss the claims by the International Monetary Fund and World Bank, that China is the "third largest" economy in the world, as an attempt by these institutions to force much harsher conditions on China. In 1993, Finance Minister Liu Zhongli dismissed the IMF's contention as misleading manipulation of statistics, and State Statistical Bureau spokesman Zhang Zhongi said that China's statistical accounting is too backward for its economy even to be measured by the IMF's methods. Per capita income in China is only $400 *per year*, he said, although Gross Domestic Product reached $458.6 billion, the 10th largest in the world. But industrial output amounted to only 27.2% of GDP, 14% below world average. The food production structure, literacy, education, and per capita living space all put China as a low-income nation.

In July, Foreign Trade Minister Wu Yi told visiting U.S. trade official Jeffrey Garten that "China will not restore its GATT contracting status at any cost. China will seek a principle of balance between rights and obligations, and will not trade off the state's fundamental interests for the sake of reentry." On Nov. 28, China's chief trade negotiator Long Yongtu announced at the GATT negotiations in Geneva that China "really can do without GATT." China's leaders "at the highest possible level," he said, had set a deadline of the end of 1994 for concluding substantive negotiations on the issue, although technical negotiations could go on. Long said that the U.S. is using China's desire to join GATT as "a lever to squeeze us."