China's economic 'boom' is built on Hongkong frenzy

by Michael Billington

In the spring of 1987, *EIR* founder Lyndon LaRouche forecast a market crash for approximately October of that year, based on his analysis of the state of the global speculative bubble and the refusal of responsible officials to change their policies. In October, a collapse in the Hongkong market was the spark which set off precisely the global panic of which LaRouche had warned.

Today, the world markets, pumped up to a speculative level beyond the imagination of previous eras through the burgeoning derivatives markets of the past six years, is again poised for an inevitable collapse, and again the Hongkong bubble may be the first to pop. Late November tremors could well be the early signs of the earthquake to come.

The Hongkong Stock Exchange has become the primary financial center for foreign speculation in the bulging Chinese real estate and cheap-labor market. Over the past year, the Hang Seng index has leaped by over 60%, from 5,500 to over 9,000, with most of this increase coming in the last four months. While this market has often had a volatile response to political events in Beijing and to the ongoing acrimonious negotiations over the 1997 return to Chinese sovereignty, this year's explosion has generally ignored the political crisis, while following the hectic pace of the unbridled and unregulated hyper-speculation unleashed by Deng Xiaoping in his highly publicized February 1992 trip to Shenzhen, the free trade zone on the Hongkong border. The mild efforts to rein in the most extreme speculative aspects of the economy, carried out over the past six months under the direction of Vice Premier and economic czar Zhu Rongji, had only a minor impact on the free-wheeling southern provinces, and the Hongkong market craze didn't even pause to take a break.

With Beijing now locked in an intense internal battle between those most directly profiting from the speculation, and others trying to reassert some central control and prevent the country from blowing apart, the political realities may reassert themselves on the Hongkong market at any moment.

Money flows rival Wall Street and London

In addition to the bubble in stock values, the global derivatives fiasco—the over $1 trillion *per day* speculation in currencies, futures, swaps, and other non-equity paper—has transformed the Hongkong market into a smaller version of the deregulated "Casino Real" of Wall Street or the City of London.

The Dow Jones Hongkong publication *Far Eastern Economic Review* (*FEER*) quoted the head of Peregrine Brokerage in Hongkong warning that the derivatives buildup "compounds the level of volatility and the speed of the run-ups" in the market as a whole. The British colonial government in Hongkong is *relaxing* regulations on derivatives, with more "innovations" to be introduced by the end of the year. Says the *FEER*, "It isn't clear how much more volatility will be introduced on the back of these innovations, but nobody believes they will result in less volatility. That means that once sentiment turns, any slide can turn into a rout."

Other Asian markets, especially Singapore, Thailand, the Philippines, and even Australia, have experienced a parallel bull market since the summer. Much of this is credited to the giant U.S. investment banks such as Morgan Stanley, Goldman Sachs, and Lehman Brothers, who have funnelled an estimated $5 billion per month into Asian equity markets alone. Predictions of imminent collapse have been issued by several Hongkong and London financial analysts, while the *FEER* wishfully claimed the probable collapse in Hongkong is "extremely unlikely to provoke a global tumble."

The fragile Chinese boom

The untenable nature of the Chinese economy, whose growth is supposedly the base upon which the Hongkong market is rising, was demonstrated by the inconclusive results of the Third Plenum of the Communist Party Central Committee held last month. Before the plenum, government spokesmen announced a series of policies to be implemented in the new year which were to be "agreed upon" at the plenum. Although

The financial district in downtown Hongkong, where the heroin-linked Hongkong and Shanghai bank stands next to the bedecked communist Bank of China.

the proceedings were kept secret, under threats against reporters who leaked news from the meeting, it became clear that agreement was not reached on at least some of the policies. The most important was a tax reform aimed at reversing the drastic collapse of revenues coming into the central government. The cumulative failure to invest in the industrial and agricultural infrastructure, in favor of the quick returns from the low-technology export industries along the coast, has left the state sector industries (including virtually all the medium-sized and large industries) in an increasingly unviable situation, with over one-third of them losing money, and falling profits from the others. These profits had constituted the bulk of Beijing's revenues.

At the same time, the "decentralization" of the reform program has left the bulk of the rising tax revenues from the private and semi-private industries in the hands of *provincial* governments. Thus, Guangdong, for instance, is awash with cash, while the rest of the nation starves.

On Oct. 31, before the plenum, officials announced that the new tax reform was already agreed upon. They said that the revenue crisis had reached the point that 60% of total taxes went to localities, and only 40% to Beijing. The reform would exactly reverse those percentages. The head of the Financial Science Institute told the press that "the tax reform package will be implemented throughout the country once it has been introduced, and there will not be any experimental units."

However, the communiqué following the plenum failed to mention the tax reform, and it is widely acknowledged that the southern provincial leaders—backed up by the Anglo-American speculators—forced Beijing to back down to some extent. Vice Finance Minister Xiang Huaicheng reported on Nov. 23 that the tax reform *would* be implemented, but it remains to be seen if it will be possible.

Beijing's ability to enforce policies in Guangdong, in particular, is extremely limited by the virtual Hongkong (i.e., British) dollarization of the province. Not only do most businesses and stores transact business in Hongkong dollars, but most investment income is generated locally or comes directly from Hongkong. Guangdong is dependent for only 2% of its funds from Beijing, compared to 80% in 1980. Any attempt to reassert control over the hot-money regime in Guangdong will aggravate the threat of regional divisions and the breakup of China.

Dollarization

The "dollarization" of the entire Chinese economy is proceeding nationally as well, in part because of the drastic need for funds in Beijing. In addition to the collapsing domestic revenues, there was a fall in foreign exchange reserves this year, reversing a four-year increase. An import surge has created a trade deficit which may hit $10 billion, versus a $4.4 billion surplus in 1992. But the largest drain on foreign reserves is capital flight, much of it drug money, estimated at $18 billion per year by economists quoted by the *Asian Wall Street Journal*.

The Beijing government has responded to this crisis by raising dollar-denominated debt both on the Eurodollar market ($297 million in September) and in Hongkong ($300 million in November, the so-called Dragon Bonds underwritten by Lehman Brothers). They intend to issue another $500 million soon in the United States, called Yankee Bonds, and there appears to be no limit to the expansion of this process of locking the government into private dollar debt.

Simultaneously, the government appears ready to submit to the chorus of demands from the Anglo-Americans to make the yuan convertible. Milton Friedman, following a series of meetings in Beijing, denounced the current two-tier exchange rate as "an absolute recipe for corruption," and demanded that the government "eliminate all the rules and regulations" concerning currency controls and other areas of government intervention. The U.S. Treasury Department on Nov. 24 also denounced China's regulated exchange system as "manipulating currency rates for its own advantage." The fact that such deregulation policies implemented in Russia and in Third World nations have allowed for massive flight capital and the outright theft of national resources by international speculators, is ignored in these discussions.

In fact, discussion of a "big bang" approach to the reforms, or "shock therapy," has increasingly come into the debate on the future of reform. Until recently, such terms have been carefully avoided in public pronouncements, in order to maintain the impression that the "China model" would not follow the disastrous course of the "shock therapy" in eastern Europe. Even while Russia has now experienced its own "Tiananmen massacre" under the guise of the enforcers of the International Monetary Fund's (IMF) "shock therapy," the western financial press gloats that Chinese officials are increasingly open to the idea that the problems in the economy are the result of going "too slow" in eliminating all government direction of the economy, and that shock therapy is necessary. Deng Xiaoping, from whom a single word can transform national policy, said just before the plenum that "slow development is not socialism," which could well be enough to end all caution and unleash a new "shock" of deregulation.

Such shock therapy is already being implemented in regard to the work force. Millions of workers in the state sector, including mining, industry, and state office employees, have been laid off, ending the cradle-to-grave "iron rice bowl" policy of the Maoist era, but without replacing it with any unemployment net. The victims simply join the "blind flow" of nearly 200 million unemployed who supply the recycled labor for the sweatshops in the free trade zones (see box). Beijing has also reintroduced wage controls, which had been relaxed as part of the reform measures, and which allowed partial autonomy for state enterprises. State enterprises which have had decreasing profits are instructed to either fire workers or reduce wage scales, ignoring the lack of infrastructure which renders individual firms incapable of reversing their financial losses.

Hamiltonian banks mooted

One reform which appears to be ready for implementation next spring points in the direction of a Hamiltonian solution to the credit crisis. Based on the Ministry of International Trade and Industry (MITI) model in Japan, China will establish three "policy banks," one for agriculture, one for long-term credit and development, and one for import and export. These banks would be separate from the People's Bank, and would be able to direct credit toward productive activity as demanded by the needs of the national economy as a whole. There is an internal debate over the question of the source of funds for these policy banks. The director of the Financial Research Institute of the People's Bank told the *Wen Wei Po* on Nov. 2 that the only source of new funds would be either issuing state bonds, thus further aggravating the debt situation, or "granting a certain amount of loans by the central bank," but he added that there is opposition to the latter.

The generation of such new credit by the government would, as Alexander Hamilton's policies did in the United States, provide the basis for launching the massive transformation necessary to avert a breakdown, if China were to reverse its *current* destructive labor policy, and *if* the new credit structure rejected the free-trade, service economy ideology of the IMF in favor of massive energy and infrastructure development, utilizing the most advanced technologies.

It is extremely unlikely that such a transformation will, or even would, take place under the current Communist Party leadership. It is now a question of which comes first: an internal breakdown in the People's Republic, or a crash of the "China bubble" in Hongkong.

Slave labor in China

EIR's reference to the "China model" as a slave-labor policy was confirmed in blood last month when a doll factory in Shenzhen, the leading trade zone across from Hongkong, burned to the ground, killing 81 people who were "locked into a cage-like workshop," according to the official *China Daily*. The firm, owned and managed by a Hongkong firm, had locked three of the four gates and covered the windows with heavy wire mesh. The Shenzhen fire chief told *China Daily*, "The purpose of the cage-like workshop is to prevent workers from stealing the products. However, people working in it can hardly escape."

Almost all the workers were women migrants from Sichuan province in the interior, part of the 200 million "blind flow" who are recycled through the sweat shops in the free trade zones.

The conditions in the plant were neither unknown by the authorities nor uncommon. Officials who had inspected the plant in March had merely notified the manager of safety improvements which were needed, with no subsequent followup.

A disaster in Thailand last May, also in a Hongkong-owned doll factory, differed only in that the workers were not caged in. When 188 workers were killed in that fire, the responsible Hongkong company, Kadar Holdings, was purchased, the *next week*, by a group of Hongkong and Beijing investors, including the son of Deng Xiaoping.—*Michael Billington*