China draws lessons of Barings collapse

by Mary Burdman

The debacle of Barings Bank has become the byword in China for the disasters of derivatives speculation. When the $1.2 billion Barings bankruptcy hit on Feb. 26-27, the Shanghai stock exchange was reeling from a near-meltdown on Feb. 23. Speculation in treasury bond futures by Shanghai International Securities, China's biggest securities firm, sent prices skyrocketing. SIS began mass dumping to try to force down the market, 10 minutes before closing time. To prevent chaos, the exchange was shut down completely for six days, and officials demanded that traders "unwind" their positions through negotiations.

The reaction at the highest levels of government has been hard and fast. Just after the National People's Congress opened its yearly session in Beijing on March 5, Executive Vice Premier Zhu Rongji held a meeting with China's top economists and government officials to tell them to study the case of Barings and the Shanghai scandal, to learn lessons in financial management, according to European Chinese-language press reports.

The same day, the official *China Daily Business Weekly* published a front-page interview with Li Jiange, vice chairman of the China Securities Regulatory Commission. Li, described by *Business Weekly* as "one of the leading figures in domestic economic circles," announced that China is planning a three-pronged program of "bold measures" to tighten control on the futures markets. This will include new regulations, legislation, and measures for international cooperation. The chaos on the Shanghai market "presents the best example of how dangerous the futures market can be without strict supervision," Li stated. "The disruption of treasury bond futures trading in Shanghai highlighted the need for strict controls on the market, which carries high risks."

At the same time, domestic Chinese enterprises will be prohibited from speculating in financial derivatives, Li announced: "The collapse of Britain's oldest investment bank, Barings, illustrates the need to strengthen control in this field." Derivatives trading can carry very high risks, he said, and Chinese enterprises have "suffered dearly" on overseas markets. "Many Chinese investors suffered losses because they did not understand the market, and many reported that they were defrauded," *Business Weekly* reported. Now, the government will only allow trading for the purpose of hedging, under strict supervision.

The central government had not taken note of the development of futures markets until 1993, when many companies were already trading on overseas futures exchanges, leading to a "massive outflow of foreign exchange and state assets," *Business Weekly* wrote. In 1994, Beijing began to take strict measures, ending trading overseas and cutting the number of Chinese futures exchanges from 50 to 15. Now, Li Jiange announced, the number of treasury bond futures exchanges will be cut from 10 to 5-6; the remaining 15 futures exchanges will also be put through another inspection.

While China's Securities Regulation Commission will seek closer cooperation with the United States, Japan, and the United Kingdom on dealing with derivatives, there is no chance of China opening its futures markets to international investors at this time, Li announced: "It is impossible for China to open up the futures market, or the A-share market, before the renminbi [the currency] becomes freely convertible." This is not something likely to happen soon, as Prime Minister Li Peng made clear last November when he warned of the danger that a new "Black Friday" crash in the United States would pose to China. Although there will be a "gradual opening," China's futures market is not ready to deal with a possible huge inflow of foreign exchange, Li Jiange said.

It was also reported in early March that Beijing is replacing the head of the Securities Regulatory Commission, Liu Hongru, who was already disciplined publicly in June 1994 for colluding with Goldman Sachs, Merrill Lynch, and Morgan Stanley to list the most profitable Chinese companies on Hongkong and New York stock markets. Liu Hongru was also an advocate of early moves to make China's currency convertible.

China will not forget

The international financial chaos is bringing up profound historical memories in China. "We should not forget this piece of history. We paid a high price," the representative of the China International Trade and Investment Corp. (CITIC) told the London *Financial Times* in an interview on March 15. Prof. Xu Shiwei was speaking after negotiations with representatives of the London Metals Exchange on some $40 million in debts claimed by LME brokers for speculative losses by traders from CITIC's Shanghai branch.

China will not forget. They have never forgotten the British Empire's Opium Wars, nor the British seizure of the colony of Hongkong. London will also take note. When George Bush's secretary of state, James Baker, once barged into Beijing in the early 1990s, in an attempt to bully China into trade concessions, and got nowhere, the British press reacted with glee. Headlines remembered Britain's hapless 18th-century envoy Lord MacCartney, who was sent packing by the Chinese emperor for refusing to kowtow.

Suing Wall Street

Meanwhile, despite the fact that CITIC has negotiated a settlement of some $15 million in speculative debts to Wall Street's Lehman Brothers and Merrill Lynch, the state-owned International Nonferrous Metals Trading Company (Minmetals) went ahead on March 9 with its countersuit against Lehman Brothers in U.S. District Court in Manhattan (see *EIR*, Jan. 6, 1995). Minmetals is suing on the grounds that Lehman Brothers induced one of its traders to make "more than $35 billion in unauthorized derivatives trades unrelated to its business." Minmetals is seeking $128 million in damages. Lehman Brothers had sued Minmetals last November, when the Chinese company refused to pay Lehman Brothers' claimed $53.5 million in debts and unpaid margin calls.

The Minmetals suit states that Lehman executives seduced a trader, Hu Xiangong, into making "incredibly complicated derivatives transactions that were impossible for him to understand." A lawyer representing Minmetals said: "This is a classic case of a global investment bank putting profits before prudence, and grossly and negligently disregarding the interests of its client." The Chinese trader was not authorized to make any of the trades, the lawyer said, and Lehman Brothers did not disclose the full risks of trading.

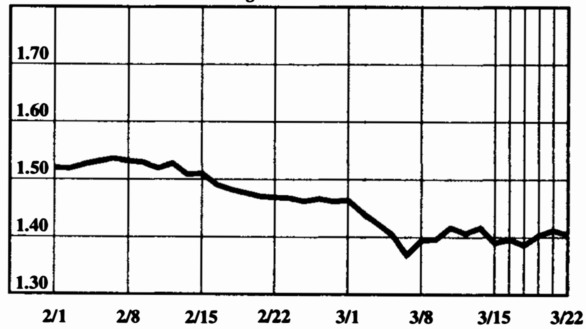
At the same time, although Lehman Brothers professed itself happy about its $7 million from CITIC (the same week, Lehman announced that it had to lay off top traders to save hundreds of millions), the *Financial Times* was not impressed. An editorial on March 2 stated: "It would be rash to conclude that [China] is setting a new pattern for its handling of commercial affairs. . . . China has yet fully to acknowledge . . . the importance of mutual confidence in international market dealings."

In London on March 15, CITIC representative Xu Shiwei admitted that "there have been some compromises." But he also said that the view being presented in the West, that China is "failing" to pay its debts to western banks, is a campaign to smear China and CITIC. He insisted that this did not have the effect intended, of getting the government to pressure CITIC to pay up. He also maintains that CITIC Shanghai is a subsidiary and not a branch of the parent company, and is therefore responsible for its own debts. The Shanghai traders are now in jail for violating Chinese law. Xu said that while "ego and greed were at work" at CITIC Shanghai, at the same time, "some LME brokers intentionally or unintentionally encouraged CITIC Shanghai to overtrade." Also, some LME brokers used "historic price carries," an esoteric method of rolling over futures contracts, "to help the detainees [the imprisoned Chinese traders] hide the losses."

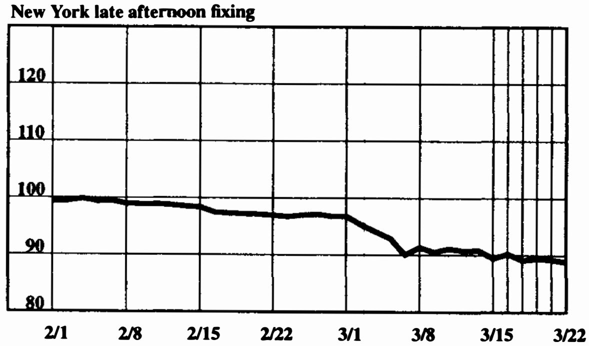
Heads continue to roll. On March 15, CITIC Chairman Wei Minguy resigned. While Beijing said that the resignation was not "directly" related to the $40 million in losses CITIC Shanghai made on the London Metals Exchange, it is very likely that the entire leadership of CITIC will be reviewed.

Currency Rates

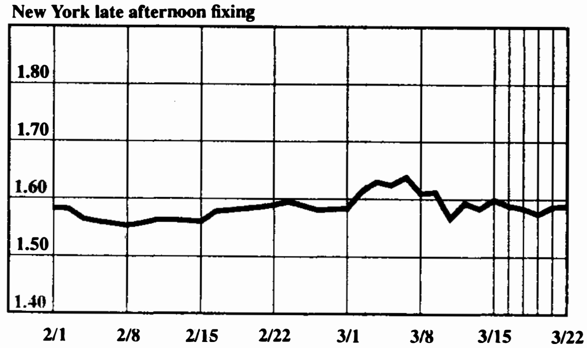
The dollar in deutschemarks
New York late afternoon fixing



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