China assesses international financial breakdown crisis

by Mary Burdman

The relentless, ever-worsening global financial collapse is causing extreme concern in China. Over the recent weeks and days, as Asian nations' currencies and stock markets melt down, Beijing's government leaders have been stating, more and more clearly, that the situation poses grave dangers for China. In his Dec. 31 New Year's message, President Jiang Zemin "pointed out that the Chinese government is extremely concerned about the financial turmoil that recently hit a number of countries and regions," the official Xinhua news agency wrote. Highest-level members of the government, now repeatedly are referring to the "global," rather than just "Asian" crisis.

Since the National Financial Work Conference on Nov. 17-19 (see *EIR,* Jan. 9, 1998), one high-level conference after another has been held in Beijing and other Chinese cities, to assess the real economic and financial situation. These included the National Economic Work Conference in Beijing Dec. 9-11, a National Economic Planning conference Dec. 13-16, and the first national conference on foreign investment in 14 years. Such conferences are generally held annually, to discuss the coming year's economic development, but the attendance—at the highest levels of government—and the serious tone of the discussion, are, as the Chinese press comments—"rare indeed." At most, not only have President and Communist Party chief Jiang Zemin, Prime Minister Li Peng, and Executive Vice-Premier Zhu Rongji, been speakers, but also members of the State Council, China's cabinet, and of the standing committee of the Party political bureau.

The themes of these conferences are the urgent lessons to be drawn from the debacles in other Asian nations, to be applied to China's own underdeveloped economy and debt-plagued internal financial system, and the potential threat to China's rapid economic development, posed by the imminent danger of the collapse of trade and of foreign investment. Despite its real, productive economic growth in recent years, China remains a developing-sector country, with the long-term economic problems of a huge, underdeveloped labor force and inadequate capital investment. These are not problems to be easily solved, but, due to the urgency of the current situation, in the end of 1997 discussions, China's policymakers set a target date of three years, during which the reform and transformation of key state-run financial institutions and industry must be achieved. Massive as that task is, as the crisis deepens daily, Beijing's leaders are perceiving that they may not have a grace period of three years.

A commentary in *People's Daily* Dec. 15 stated: "The financial crisis in Southeast Asia has sent shock waves around the globe and the issue of economic security has become increasingly prominent; . . . The financial crisis in East Asia has been a major event in the economic field this year. This crisis has shocked the whole world and has made a profound and far-reaching impact. It shows that the sweeping economic globalization has posed new challenges to developing countries. . . .

"In the international financial field, institutional investment has been playing a major part, there has been a huge amount of international idle capital, information technology has been extensively applied, and the flow of capital has been rapidly concentrated, giving rise to strong impact of international speculation, drastic market fluctuations, and greater financial risks. Some newly emerging countries and regions in Asia have relied too heavily on inward investment and foreign trade, whereas their export products and export markets have tended to converge, their economic structures have not been rational enough, and the content of technology in their products has not been high. . . . This, together with underdeveloped financial systems and slack financial regulation, has eventually led to a crisis. In this crisis, the social stability of some countries has been affected and signs of political instability have emerged in some of the countries."

This is a matter of strategic interest for China. In June 1990, senior statesman Deng Xiaoping had told a group of foreign visitors to Beijing, that "stability, order, and productivity" were the three key issues for China. This statement was released internationally through the official Hong Kong paper *Wen Wei Bao*. Without a stable China, he said, the whole world will not be stable. China urgently needs several decades of peace to develop its economy for its huge population, Deng said; this is a fundamental policy of Chinese domestic and foreign policy. The potential for chaos in East and Southeast Asia, brought on by the current financial meltdown, now poses a threat to that necessary peace.

China is the one nation which is actually building a productive real economy, and, this sound economic growth, based on the construction of infrastructure and industry, and its ability to feed its huge population, is China's real strategic security. As President Jiang Zemin said at the Dec. 15-16 informal Asian summit in Kuala Lumpur, "Economic security should cover financial security." China has allowed only very limited convertibility of its currency, and refuses to comply with the free-market demands of the World Trade Organization, and will not waver from these policies.

For these reasons, as Lyndon LaRouche has emphasized, if any nation can survive the coming world financial collapse, it is China.

The problems of China's internal financial sector, make the reform of the state industry all the more urgent. The critical problem is re-employment of the huge numbers of excess workers. According to official statistics at the end of September 1997, some 10 million workers had already been laid off from the state-run sector of the economy. Beijing's current plans are far too dependent, on foreign investment and export industries, to create employment for many of these workers. This is a serious vulnerability. As Minister of Foreign Trade and Economic Cooperation Wu Yi pointed out in a year-end interview with *People's Daily,* "Each year, 80% of China's import and export is realized in the Asia-Pacific region, and 90% of foreign capital utilized by China comes from this region. . . . The sustained turbulence in the worldwide financial markets triggered by the financial turmoil in Southeast Asia will have a certain negative impact on the development of the world economy next year and the growth of demand on the international market will also be restricted," she acknowledged.

While the introduction of technology from abroad is obviously crucial to China's development, there is also an exaggerated perception of *dependence* on imports of capital from abroad, which tends to overlook the enormous potential of the productive capabilities of China's own huge economy. The problem is a tendency, also created under pressure from the radical free-market economic policies rampant in the West, to confound the national policy of "opening up," which is essential for China's international development, with *dependence on* importing funds and technology, to enable the economy to grow.

The global crisis

In his New Year's message, "President Jiang Zemin said that people of all countries across the world should make joint efforts to usher in a new century of enduring peace and common development," Xinhua reported. " 'Generally speaking, we have continued to maintain stability in the overall situation of China's reforms and development,' he asserted. However, he pointed out that the Chinese government is extremely concerned about the financial turmoil that recently hit a number of countries and regions."

"We are paying close attention to the financial turmoil which has taken place in some countries and regions recently," Xinhua quoted Jiang Zemin, "and we believe that, because of the efforts of these countries and regions as well as international support, the situation will gradually improve. On the whole, the overall performance of China's reform and development will continue to be stable.'

However, Jiang Zemin warned, "The world is still not peaceful. The gap between the rich and the poor countries in the north and the south is still widening; regional conflicts still occur from time to time; the old unjust and unreasonable international political and economic orders remain basically unchanged; developing countries are still at a disadvantageous position in the fierce international economic competition; and mankind's subsistence and development are still facing all kinds of threats and challenges. The prospects for peace and development are bright. The 21st century will be a century full of hope. The road ahead will not be smooth sailing, however. The key requirement is that people throughout the world continue to unite and work together to establish a just and rational international political and economic new order at an early date."

Prime Minister Li Peng also spoke of the global financial turmoil in a New Year's interview. In *Zhonghua Yingcai* (*Chinese Elite*), Li Peng said that, while "China has not been affected by the spreading financial turmoil, he added that, since the financial turmoil is global, and the Chinese economy is closely associated with the world economy, there might be some belated impacts; but that further observations have to be made in this area." The New Year's editorial in the *Renmin Ribao* Dec. 31 stated: "While many countries were stricken by the international financial crisis, our country managed to maintain stable development in the financial situation and in the economic situation as a whole. . . .

On Dec. 29, Xinhua published a most interesting assessment of the "180-degree turn" in the U.S. attitude on the financial crisis in Asia, in a commentary written from Washington. While the first U.S. response, during the summer, was that "all the aid should proceed through the IMF," by the autumn, when the Indonesian and South Korean crises hit, the United States showed it was "to form a 'second line of defense' with Japan, China, and Australia, . . . the Group of Seven and other nations." This turn "suggests that the top U.S. authorities are taking a new view of the Asian financial crisis and are aware that the IMF aid alone will not be adequate to rescue the R.O.K. [Republic of Korea] from its crisis. This was absolutely out of 'consideration for the U.S. economy and national security,' said [Treasury Secretary Robert] Rubin."

Foreign investment

China's trade and foreign investment will suffer directly from the crisis. One indication of how concerned China is about the potential loss of foreign investment, was the announcement in the *China Daily Business Weekly* Jan. 4, that Zhu Rongji, responsible for the economy, had "made it clear" that preferential tax breaks for equipment imported by foreign investors, which had been ended in April 1996, would be restored from Jan. 1, 1998.

Overseas investment makes up more than 20% of China's total expenditures in fixed assets. State Statistics Bureau spokesman Ye Zhen said Dec. 30 that China's GDP had grown by 8.8% in 1997, a significant fall from the 9.7% of 1996, and some officials and economists view this assessment of GDP as too high. Ye Zhen acknowledged that foreign investment would fall, and noted China's overall economic problems, which, he said, "have aroused the government's keen attention." These include serious problems in agriculture, where 80% of the population works, irrational economic structure, heavily indebted, loss-making industry, and a large number of laid-off workers.

The volume of contracted foreign investment "sagged" in 1997, and an official from the State Planning Commission told the *China Daily* that, due to the turmoil in Hong Kong, Southeast Asia, and Taiwan, its traditional sources for 65% of total overseas investment, China would "explore fund sources" in Europe and America, especially the European Union. Build-operate-transfer and fund-raising projects, as well as projects that issue stock overseas, will be encouraged.

In her interview Dec. 30 with *People's Daily,* Minister of Foreign Trade and Economic Cooperation Wu Yi said China's tariffs will be lowered to reverse the "consistently weak" import growth "especially of advanced technology and equipment." China's "trade surplus has been expanding yearly, and import and export have been unbalanced in recent years," she said. "China's export commodity mix and export market structure are similar to those of Southeast Asian nations, so the financial turmoil in Southeast Asia will weaken the export competitiveness of our products. . . .

"The State Council has decided to exempt equipment imported for state-encouraged and state-supported projects funded by foreign and domestic investors from tariffs and import value-added tax [VAT]. The purpose and significance of this decision is to increase the use of foreign capital, encourage the import of advanced technology and equipment from abroad, promote industrial restructuring and technological advancement." The areas concerned include high-technology industries, agriculture, infrastructure, new technologies, machinery, and projects in China's central and western interior. There will also be a revised regulation on areas where foreign investment is to be encouraged. Other measures, to encourage foreign investment and expansion of commerce, tourism, trade, construction, and accounting, will be announced.

The Asian meltdown is already taking a bite: The late-December issue of the State Council-sponsored newspaper *China Economic Times* reported that China's steel production is already being hit by lowered demand from Southeast Asia. "The Asia-Pacific region will see its need for rolled steel decrease by 20%. In areas severely affected by the crisis, such as Thailand, most construction sites have been halted and some car manufacturers will cease production for a few months," the report stated. In addition, China's domestic market could be flooded by steel produced in other Asian nations, priced low after the collapse of their currencies.

Tao Liming, director of the International Finance Research Institute of the Bank of China, said Dec. 15 that the sharp Asian currency devaluations will also affect China's export of labor intensive products such as shoes and garments, and that foreign capital inflow into China will slow down in 1998 due to investor caution about the Asia-Pacific countries.

Anniversary of the reform

This year is the 20th anniversary of the Third Plenary Session of the 11th CPC Central Committee, where Deng Xiaoping announced his plans to reform and transform the Chinese economy. China has made enormous strides during the past two decades, but enormous problems remain—something taken very soberly by the national leaders. An article published Dec. 14 in the well-known Beijing magazine *Outlook,* was an effective reminder that China remains a poor developing country. "Courageously facing that reality should be the starting point of everything we do," the article stated. Despite is ever-growing size, the Chinese economy's efficiency remains low. "For every 100 yuan of added industrial value in 1994, China used 32 times more energy or 15 times more electric power than Japan did, *Outlook* reported. China remains basically an agricultural society, with 80% rural population. While literacy is higher than the world average, higher education is severely limited. In 1993, only 3.3% of the population had the opportunity for higher education, compared to 4.9% in India and 48.2% in the Republic of Korea. Science and technology currently contribute more than 60% to the national economy in industrial countries, but in China the figure is about 30%. In addition, without a sound pension and social welfare system, China is an aging society, with almost 10% of the population, 120 million people, above 60.

The Central Economic Work Conference

The Dec. 9-11 Central Economic Work Conference in Beijing focussed on "the principle of seeking progress amid stability." But while China had achieved "high growth and low inflation" in 1997, profound problems remain. The

Beijing authorities will have to walk a fine line to see the situation through. The greatest problem is the massive over-employment in agriculture, of 800 million peasants. It is understood among China's policymakers that the stagnation of the vast agricultural sector, the very low living standards of the peasants, and the lack of industrialization and urbanization of the countryside, have hindered the development of the whole economy.

Then, there is the barely begun reform of the state-owned enterprises, including the growing social problem of laid-off workers and staff, and the multiply-entangled problems of China's domestic financial sector. It is clearly recognized that the government must get out of the direct, daily management of enterprises—a task no government can do well. As a Xinhua commentary Dec. 11 stated: "It is necessary to properly reform the government structure to realize the separation of government administration and enterprise management, and to establish an efficient supervision and operational mechanisms for state assets."

At the economic conference, Jiang Zemin emphasized that stability demands ordered, controlled, and new measures for expanding the economy and improving living standards, but, at the same time, stagnation is not acceptable. All aspects of the domestic and the international economic situation must be "scientifically" assessed to avoid serious mistakes and prevent any externally triggered financial crisis. China's senior leaders must not make impetuous or blind decisions, Jiang Zemin said; "localism and departmentalism" must not determine policy; the central authorities' policies must be followed, and the interests of the broad population must be met.

The situation of the state industry and financial institutions is indeed difficult. Many of China's state enterprises are burdened with debts as high as 70% to 80% of assets. Many also carry excessive numbers of employees. In recent years, another 4 million new staff members have been added to the state enterprises, when only 1 million were needed, a situation characterized as: "One man is sharing the food of three." Those enterprises still caught in this situation, cannot operate efficiently or invest in the new technologies they urgently need, and cannot be effectively managed. In addition, there is a general tendency to duplicate production of "profitable" products, with enterprises all over China rushing out to make whatever is selling well at the moment—with predictable wasteful results.

The state banks are carrying bad debts of up to 30%, due to the inability of the enterprises to repay loans. In A commentary on the Central Economic Conference in *Wen Wei Bao* Dec. 13 stated: "When state enterprises borrow from state banks, they still think that "the wallet is the undergarment covering the chest and abdomen," and assume there will be no problem if the loans become bad debts. But, China's leaders fear that the practice of treating the state-owned commercial banks as cash windows, might have created a situation inside China, too much like that of the Southeast Asian economies. While, of course, the Chinese debt is internal, and therefore not vulnerable to the dangerous insanity of the current international markets, the lesson on sound economic policy is well taken.

Policy set at the conference, included that, in 1998, all new industrial projects, outside the critical area of "technical transformation," must be suspended; special policies applied to enterprises and the heavily indebted state grain department to relieve the debt burden; while the growth of bad loans must be stopped. Regional bank managers must be answerable to the central bank, not the demands of local authorities, and responsible for the financial health of their institutions—at the risk of their positions.

The reform of the enterprises will focus on 500 large and medium experimental enterprises, with the main target in 1998 the textile industry. Government, the enterprises, and society in general, meanwhile, have been declared responsible for sharing the funding to sustain the 10 million laid-off workers. This responsibility will grow, as projected layoffs in each of China's main industries will range from several hundred thousand to over 1 million.

According to press reports, Zhu Rongji stated, at the close of the conference, that the Asian financial crisis was more serious than expected, and that China had not foreseen any such developments in these countries. Dissension within China about the urgent implementation of policies of industrial and financial reform, to ensure stable economic strength, and powerful financial monitoring, must end, he said.

Financial reform

On Dec. 27, Dai Xianglong, governor of the People's Bank of China, was commissioned by the State Council to tell the National People's Congress Standing Committee about the risks in the country's financial sector. China's overall economic development and its broad financial statistics are sound, he said. Foreign exchange reserves are over $140 billion, the currency stable, and its foreign debt payment rate and debt ratio, at 11.81% and 13.97%, respectively, are lower than the international standard risk lines. "Nevertheless, we should not overlook the problems existing in our financial sector," Dai announced, especially the bad loans of the state commercial banks. More problematic are the non-banking financial institutions, many of which are unsound and some verging on bankruptcy. Dai warned that China must avoid a "bubble economy. . . . It is also very important to open financial sectors in a very prudent and step-by-step way." In addition, strict control over the flow of capital is being implemented in China, he said.

Financial reform in China will put responsibility for management of immediate lending volume and targets on the banking sector itself, rather than government departments in

Beijing. State-owned commercial banks will concentrate on the large and medium-sized enterprises that are the core of the national enterprise reform project, and local banks will be developed to deal with local affairs. The People's Bank of China has also decided that, in 1998, it will lift controls on the loan ceiling imposed on the state-owned commercial banks and policy banks since the introduction of its tight credit policy in mid-1993. The aim is to get away from the laborious "up from the bottom and back down from the top" process of deciding specific loan priorities, and allow decisions to be made on the basis of genuine regional needs. However, general central policy is to be strictly enforced. National inspection programs—an institution in China—are to be focussed on the financial sector, Dai Xianglong said.

It was reported that Zhu Rongji's Dec. 28-29 "inspection tour" of the Beijing-Kowloon railroad, was also used as a reason for an unannounced visit to southern China, especially Guangdong province, to look into reactions to the Asian financial turmoil, and to call for enforcement of the policies enacted at the November Financial conference. Zhu Rongji announced there a "major readjustment of the investment structure," emphasizing that useless or duplicate industrial investment should be stopped, and that the state will pay still greater attention to the development of infrastructure facilities, farmland water facilities, and housing reform.

The investment conference

The urgency of the question of foreign investment, was demonstrated when the State Council held a national conference on foreign capital in Beijing Dec. 22-24, only the second such conference in modern China, and the first since 1983. The conference was addressed by Jiang Zemin, Li Peng, Zhu Rongji and Li Lanqing, and Wu Yi.

While the importance of utilizing foreign capital in the "national opening-up" policy, and China's success in using over $360 billion in foreign capital over the past 20 years were emphasized, Jiang Zemin also noted that China must correctly maintain the relationship between its open policies, and "maintaining independence, initiative, and self-reliance," and "pay attention to maintaining the country's economic security."

This is a serious question. Foreign funding has already accounted for 14% of China's total investment in fixed assets, and currently, 10% of the non-rural labor force—over 17.5 million people—are working for the 145,000 foreign-financed enterprises in China, Minister Wu Yi told the conference. Tax revenues from foreign companies in 1996 accounted for almost 12% of the year's total taxes on industrial and commercial companies, compared to 4.25% in 1992. Equally important has been the contribution of foreign advanced technology and equipment to improving China's technology in machine-building, electricity, telecommunications, and other fields. Foreign investment has also expanded China's foreign trade greatly. In 1996, the foreign trade volume of China's foreign-funded businesses was $137 billion, more than triple that in 1992. This amounted to 47.3% of China's total foreign trade in 1996, compared with 26.43% in 1992.

China's international debt situation is relatively sound, with 80% of foreign investment directly invested in long-term projects, making it less vulnerable to investment flight. Overall foreign debt growth in 1996 was less than 10%, a rate lower than in the 1980s and early 1990s. Overall debt is $118.64 billion, 88.5% of that medium- and long-term. Beginning from last year, China put all medium- and long-term foreign debt of domestic institutions under planned management.

Science and education

During these high-tension consultations, the Chinese leadership's commitment to transforming their nation remained evident. A commentary by Wang Bingqian, Vice Chairman of National People's Congress Standing Committee, in *People's Daily* Dec. 5, asserted that China's strategy must be to "invigorate" its national economy through science and education. Drawing on the deliberations of the Chinese Communist Party's 15th National Congress in September, Wang Bingqian wrote that China's state finances must be improved to guarantee economic and social development. It must be understood, that financial and scientific development are both essential. "Invigorating the state finances and invigorating the nation through science and education are unified, complementing each other. With the invigoration of science and technology, both the nation and state finances thrive," he wrote. "The basic improvement in the state financial condition must be built on the foundation of the sustained, rapid, and healthy growth of the national economy, based on the conversion from the extensive to the intensive type of economic growth, while progress in science and technology is the decisive factor in economic growth." China's imports of foreign advanced technology has both increased the rate of economic development, and of "sustained growth in financial revenue."

At the same time, state financial support is essential for the realization of scientific and educational achievements, Wang Bingqian wrote. "Research in basic science and sophisticated science involves long periods, great risks, and calls for the government to take up the organizational responsibility, with support in terms of state in funds and policy, and without which it would be very difficult to realize any major breakthrough." Even the development of applied technology is long and expensive, and "throughout the whole process, the support of state finance and taxation policy is called for. . . . True, the development in science and educational undertakings calls for the state to put in considerable financial resources, but when science and technology have developed, with the elevation of the qualities of qualified people, financial resources will grow with them."