Amidst world economic crisis, China is building its New Deal

by Mary Burdman

Over the past two months, as the world financial situation rapidly worsened, the Chinese government has been deliberately carrying out its "New Deal" economic development policy. The program is apparently already taking effect, despite the regional collapse in trade in Asia, which is badly hitting China's exports, and the disastrous floods which struck the Yangtze Valley (which has a population as large as the entire United States) and northern China.

Due to the government's investment policy, August marked a turning point for China's economy, Zeng Peiyan, Minister of the State Development Planning Commission, said in a press conference in Beijing on Sept. 23.

China has been constantly expanding the scope of its New Deal project. Zeng Peiyan stated that the massive infrastructure-development program, outlined since the beginning of this year, is being enlarged to meet the current situation. "Only if overall fixed-asset investment grows by 15-18%, can we reach 8% economic growth," he said. Earlier, in the spring, government officials had proposed 15% growth in investment to achieve sufficient economic development. Zeng said that China is proceeding with plans to spend the equivalent of $1.2 trillion on new infrastructure over the next three years. Previous figures for the level of planned investment stated by leading Chinese officials, have ranged from the equivalent of $750 billion to $1 trillion.

China's investment policy, launched in the beginning of 1998, has resulted in a year-on-year increase of 17.7% in state-sector fixed-asset investment in the first eight months of the year, Zeng said. But, there was concern that a slowdown in investment in the non-state sector, which accounts for 40% of total investment, could erode the achievements of the state sector. Therefore, the government has decided to increase spending with funds raised through a treasury bond issue worth 100 billion yuan ($12 billion). This, Zeng said, will prompt banks, local governments, and enterprises to spend another 250 billion yuan in the projects, creating another 1% in economic growth this year. Falling exports to its neighbors make it imperative that China spend aggressively to reach its economic goals, Zeng said.

"The targets proposed by the government at the beginning of the year: 8% growth in GDP, inflation of less than 3%, and a stable yuan exchange rate, can all be reached," Zeng said. He reiterated that China will not devalue its currency, the renminbi.

"Speaking overall, China's economic situation is good and the measures the government has taken to expand domestic demand and stimulate the economy have already started to take effect," he said. Fixed-asset investment growth rose to 26.9% in August, 4% higher than July. Growth in consumption also recovered to 13% in August, 1.2% more than in July. The growth of industrial added-value rose by 7.9%, compared to 7.6% growth in July.

"However, problems still exist in achieving the annual growth goal, and we need to work even harder to solve them," Zeng said. "The government will need to ensure more and efficient investment in key projects, achieve a good autumn grain harvest, expand the domestic market and export, adhere to a stable renminbi, and step up efforts in water control and resettlement of residents affected by the summer floods," he said.

During the same period, especially since the beginning of September, China has imposed more and more controls on currency movements, foreign exchange, prices, and other financial items.

Reaction to the Clinton initiative

Of greatest potential importance, have been Chinese reactions to the initiative taken by U.S. President Bill Clinton in his speech at the New York Council on Foreign Relations (CFR) on Sept. 14, when he called for an emergency international meeting on the world financial crisis.

When Clinton met Chinese Foreign Minister Tang Jiaxuan at the White House on Sept. 29, the two discussed cooperation on exactly these problems, according to Chinese reports. The national news agency Xinhua quoted a Chinese official saying that the U.S. President "has pledged to continue to work with China in stabilizing the world economic situation and to expand cooperation in various fields." Clinton himself said that Sino-U.S. relations are at "a new stage of development," and both agreed to the importance of following up the Sino-U.S. summits.

Clinton also praised China's efforts to keep the renminbi strong, and said that China had proven itself a stabilizing force in the region and the world.

Tang said that Clinton's domestic problems would not harm U.S.-Chinese ties, because better relations are the shared common wish, and serve the fundamental interests of both countries. Tang said that the scandals are a U.S. internal matter. "President Clinton has made a very important and valuable contribution to the development of the U.S.-China relationship, which is something we will never forget. I am looking forward to further sustained growth of the relationship."

Tang Jiaxuan also met Treasury Secretary Robert Rubin, and the two discussed their countries' responses to the world financial crisis, the Hong Kong *South China Morning Post* reported. Rubin praised China for maintaining the stability of the yuan, calling it "right for China and also very good for the rest of the world."

Immediately after Clinton's CFR speech, there were marked reactions in the official Chinese press. Beijing's paper of record, the *People's Daily,* published a column on Sept. 18, quoting Clinton "urging major industrialized countries to coordinate their action to jointly deal with the serious international financial turmoil at present in order to promote sustained development of the world economy." This speech and other reactions demonstrated a "positive change" in "the attitude of economic powers toward fighting the financial crisis," *People's Daily* wrote.

Previously, the industrialized nations' view that they were "immune" to the crisis, led them to refuse to take responsibility for the financial disaster, only making it worse. This refusal to act seems now to have changed. "Only the economic powers can provide effective assistance," *People's Daily* wrote. "That the economic powers and the developing countries jointly fight against the international financial crisis at present and, in the course of this, explore the establishment of a new international financial order and promote the world's prosperity and development in the next 1,000 years, are the common desire of people of various countries."

A Xinhua commentary at the same time noted the "strong signals" being sent from New York and London due to the Russian crisis. "The signal from New York was personally issued by U.S. President Clinton, [who] pointed out that the current financial crisis is the 'greatest financial challenge the world has faced over the last half-century,' that has sunk one-third of the world into economic recession."

Xinhua cited Clinton saying that the United States could not isolate itself from the increasingly fierce financial storms, and that it "has an 'unevadable' responsibility to combat the global financial storms."

The ferocity of the current "global financial storms," has forced Western nations to pull their heads out of the sand. The "sense of panic around the world must not be underestimated," Xinhua wrote. But even international meetings will not suffice. "There must be extensive common understanding, a well-thought-out plan, and practical yet bold actions. A key to putting the financial storms to rest is to carry out bold adjustments and reform of the current unreasonable international financial system, structure, and supervision and management mechanisms. In particular, by establishing new international financial laws and regulations, we should prevent a very small number of international big financial speculators from carrying out vicious speculative activities."

Speculation a 'global threat'

The Chinese Foreign Ministry gave the Hong Kong authorities its full backing in their battle against the global hedge funds, including against the nasty criticisms of U.S. Federal Reserve Chairman Alan Greenspan. "Regarding U.S. Federal Reserve Chairman Greenspan's criticism of the Hong Kong government's incursion into the stock market, Foreign Ministry spokesman Zhu Bangzao clearly stated that it is an affair within the autonomy of the Hong Kong Special Administrative Region government to adopt measures to defend its linked exchange rate and stabilize its finances. The central government understands and respects the decision of the S.A.R. government," the Beijing-owned Hong Kong daily *Wen Wei Po* reported on Sept. 18.

Just days earlier, *Wei Wei Po* had published an editorial warning that hedge fund speculators remain "a global threat." The editorial reported that Hong Kong Financial Secretary Tsang Tam-kuen, who described hedge funds' operations as "financial terrorism," will tour the United States, the U.K., Germany, and the Netherlands to discuss defense against the funds. "It is indeed a miracle that Hong Kong has remained the only region in the world boasting a stable exchange rate despite four successive attacks by hedge funds," *Wen Wei Po* wrote. "We believe that developing countries will also advance measures of exploring ways and means of fighting against hedge funds and call for straightening out the global financial order at the upcoming conference."

A Sept. 19 *Wen Wei Po* editorial accused Greenspan of "obviously . . . speaking on the side of hedge funds," when he attacked Hong Kong's intervention. "The plundering in newly developing markets by huge external funds is unethical," the daily said. Greenspan is giving the hedge funds "an outer coat of rational and ethics, which is inappropriate."

This type of discussion indicates that China is not only considering its own welfare in carrying out its increased protectionist measures, and the "free trade" cabal is most unhappy with this. The City of London's *Financial Times* and the *New York Times* are complaining of the "chill in China." The London International Institute of Strategic Studies' Gerald Seagal, whose much-touted "breakup of China" scenario of the early 1990s has proven false, recently claimed in the *International Herald Tribune* that there is an economic "crisis" inside China. The Sept. 30 *New York Times* worried that Chinese trade negotiators have been telling U.S. officials that Beijing is not so eager to win quick entry into the World Trade

Organization, and that some leaders are warning that this is the wrong time to join a body that will force China's markets to open too rapidly.

U.S. Secretary of State Madeleine Albright harped at Tang Jiaxuan during his Washington visit on Sept. 29, that the growing trade deficit between China and the United States (the size of which is disputed by China) is something that could threaten the two nations' relationship. China, claimed Albright, should take on the issue so that "it does not become a source of estrangement instead of engagement." Fortunately, she apparently spared Tang one of her song-and-dance routines.

U.S. Undersecretary of Commerce David Aaron, who was in Beijing on Sept. 24, claimed that U.S.-Chinese trade relations are at a "turning point," due to U.S. concern that China is adopting new protectionist measures. "We do not want to see protectionism spreading as a result of the crisis," Aaron said. He claimed that China's trade surplus with the United States, likely to jump 20% this year to $60 billion, was "politically unsustainable."

On his return to the United States, Aaron threatened that, in implementing stricter measures, the "Chinese authorities may be underestimating the level of frustration in the business community. There is increasing world competition for scarce investment dollars. Nowhere is this competition going to be more fierce than with China's neighbors."

Another test for China will be the visit on Oct. 6-10 of Britain's Prime Minister Tony "Third Way" Blair. There are those in China, motivated particularly by "practical" considerations, who consider all-out reform of the world financial system too great a challenge, and who might give lip service, at least, to Blair's empty blatherings about a "new" financial system, one that he demands retain all the insanity of the current, bankrupt one. Blair's nonsense will have little effect, certainly, on domestic Chinese policy; the critical question is that he not be allowed to meddle in the essential U.S.-Chinese relationship.

Quality economic growth

Already at the beginning of September, Chinese State Councillor Wu Yi, the former Trade Minister promoted to a position of eminence on trade and investment issues, said that China's economy was showing itself strong enough to ward off the risks posed by the Asian monetary crisis. At an international symposium in Beijing on transnational investment strategy on Sept. 8, Wu Yi said, in her speech entitled "The Asian Monetary Crisis and China's Economic Growth," that the Chinese government's policies for coping with the Asian monetary crisis are being demonstrated to be correct. Industrial growth in China has been 7.8% in the first half of this year, and fixed-asset investment in July was up 22.8%, which was 6.5% greater than the previous month. In addition, China's foreign reserves stood at $140.2 billion as of early August. All this, in contrast to the devaluations, surging prices, and economic recession caused by the monetary crisis in vast areas of Asia. She also described China's policy to develop its internal economy, focussed on infrastructure projects.

Speaking in Beijing on Sept. 14, Bai Hejin, secretary general of the State Development Planning Commission, the new ministry formed when Zhu Rongji became Prime Minister last year, said that the quality of China's economic growth must be maintained, not just a high growth rate. Bai warned that pursuing too-high growth, such as 10%, during the next three years, would not succeed. China should proceed with a moderate annual growth rate of 7-8% in the last three years of the Ninth Five-Year Plan (1996-2000), a transitional period for China's economy. Due to both the internal situation and the international environment, pursuing the higher growth rate will not be suitable, he said. Bai Hejin stressed: "The significance of China's economic growth does not lie in pursuing an absolute figure; in ensuring economic growth, we must not sacrifice the quality of the national economy, this is the precondition. Therefore, blind, duplicate construction solely for a high economic growth must be absolutely prohibited."

China's government has refused to allow the damage done by this summer's "century floods," estimated to cost at least $20 billion, to stall economic growth; in fact, the disaster is being used as a basis, not only to pull the nation together to combat the crisis, but to renew and expand agriculture, housing, industry, and infrastructure in the affected areas. President Jiang Zemin and Prime Minister Zhu Rongji, along with many other leading officials, have spent weeks touring the flooded regions.

Indeed, as the floods were reaching their heights, Chinese officials were announcing a series of new, massive infrastructure projects for the entire country, including specifics on nine large rail projects to be constructed over the coming years.

On Aug. 31, the *People's Daily* reported on plans to construct a rail link to Hainan, the large island province off China's southernmost coast across the Beibu Gulf from Vietnam. The rail link, which will cost about 4.5 billion yuan ($540 million), would involve building 542 miles of track and constructing China's first train ferry across the Jingzhou Strait, which separates Hainan from the province of Guangdong. The project, to be completed in 2001, will be funded by the Rail Ministry and the governments of Guangdong and Hainan provinces.

In mid-August, the Rail Ministry announced that it had completed the feasibility study and on-site route surveying for an 1,100-kilometer rail line which will connect the Tibetan capital, Lhasa, with the rail system of central and western China. The project, called the Qingcang Railroad, "will fill up a blank in our country's western rail system, and at the same time it will mark the end of the historical period when Tibet had no railroad," *People's Daily* reported. This new railroad, will be an engineering wonder, travelling through valleys between mountains higher than 6,000 meters. The total length of bridges and tunnels will be 30.6 kilometers, and the total investment, calculated in 1995 fixed values, will be 13.92 billion yuan.

The ministries of Railways and Communications are both reporting that rail and highway construction would be increased this year. By early September, Beijing had added another 4.2 billion yuan to rail investment, bringing the total for 1998 to 53 billion yuan. Some 41.3 billion yuan will go into construction of large and medium-sized projects. These include laying 1,876 km of rail tracks, and building 1,210 km of new rail lines, 575 km of double-tracked lines, and 1,091 km of electric railways. The work in the next four months will exceed that of the past eight months. In addition, construction of 16 priority projects will be intensified, including double-tracking the southern section of the Beijing-Kowloon rail line, and electrification of the Chengdu-Kunming rail line.

However, rail construction in the past few months has been slower than expected, due to a lack of preparatory work. Major problems have arisen in acquiring the land required for building the lines, problems compounded by the floods.

By Sept. 20, the Rail Ministry announced that it has spent more than 6 billion yuan on infrastructure this year. Now, rail speeds will be improved. The highest speed of trains on the three major lines—Beijing-Guangzhou, Beijing-Shanghai, and Beijing-Harbin—will reach 140-160 kilometers per hour, and a high-speed train on the Guangzhou-Shenzhen line will run at an average of 200 kph. The new north-south main line, Beijing-Kowloon, will focus on cargo transport, because it is only using 20 million tons of a designed annual cargo transport capacity of 70 million tons, while the older Beijing-Guangzhou Railway will focus on passenger transport.

In addition, railways in the severely transport-short southwestern China have been upgraded, the ministry said.

Investment in highway construction was 86.2 billion yuan in the past eight months, up 82% over 1997, employing over 3 million workers. There are projects to build 38,500 km of highways this year, costing 180 billion yuan.

Repairs of flood-damaged infrastructure will also get big investment, Xinhua reported. Some 29,000 km of roads were damaged by the floods, about 2.5% of China's total. The Ministry of Communications has earmarked 60 million yuan for repairs.

On Sept. 20, China announced that it will invest the equivalent of $7.23 billion by 2010 to build five hydropower plants. China has tapped only 15% of its potential exploitable hydropower of 378 million kilowatts, the largest in the world. Western nations, in contrast, are now exploiting 50-90% of their hydropower potential. Hydropower accounts for only 24% of China's power-generating capacity, while 70% of electricity is produced by coal-burning plants, creating a serious air-pollution problem and causing inefficient use of China's still-limited rail infrastructure to haul coal.

Hong Kong, hard hit by speculator attacks and the collapse of trade in Asia (last year Hong Kong was the busiest port in the world), is also expanding its infrastructure. While the other "Asian tigers" have cancelled all big infrastructure projects, the Hong Kong government announced on Sept. 16 that it will build its planned West Rail project, a 30.5 km double-tracked rail line, of which 45% must be built on viaducts, and 40% underground. The project will create 13,000 jobs.

Financial control

China is also steadily strengthening its control over capital flows. It is clearly recognized in China that its national policy to maintain the limited convertibility of the currency, the renminbi, has provided critical protection from the murderous attacks that the international hedge funds have mounted against all other countries in Asia. The renminbi is convertible only on current, not capital, account.

But, problems have arisen in reaction to the severity of the financial debacle in Asia, and to fears, constantly aggravated by financial speculators, that the renminbi might be devalued, despite repeated, reasoned statements of Chinese leaders that such a step would only worsen China's economic situation. China's foreign exchange reserves, at $140 billion the second-highest in the world, have not been growing in the recent period, and black market speculators in China have being pushing the value of the renminbi down in illegal street trading. While these problems, especially the second, are limited, Beijing is not taking chances.

On Sept. 28, the State Council, China's Cabinet, put out a circular calling for "strengthening the administration of foreign exchange and debt, which is a critical measure to avoid foreign financial risks, keep the balance of the international payments, and maintain the stability of the renminbi," the *People's Daily* reported. Some "localities and businesses have willfully floated overseas loans without authorization," the circular said. Financial institutions have been ordered to "exercise stricter administration of financial affairs and foreign exchange, to prevent the evasion of foreign exchange payments," the circular said.

Any enterprises with import or export management rights, which are involved in illegal dealings worth more than $1 million, will have their permits revoked.

The state must maintain "uniform supervision over the total volume and structure of foreign debts," the circular stated. Illegal overseas funding "is prohibited. Only State Council-authorized official bodies can borrow from international monetary organizations or foreign governments."

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"State-owned financial institutions must have permits from the People's Bank of China, before borrowing money from overseas organizations," the circular stated.

The next day, Wu Xiaoling, director of the State Administration of Foreign Exchange (SAFE), gave a press conference to announce measures to prevent billions in foreign exchange from leaving China. Wu said that the series of measures announced in the past weeks would put the illegal holding of foreign exchange by Chinese companies abroad under control. She confirmed that SAFE had ordered such companies to repatriate this foreign exchange by Oct. 1.

"This is nothing new," Wu said. "All Chinese legal persons are required to keep their foreign exchange within China. . . . If [companies] comply by Oct. 1, they will not be punished. If not, they will be punished."

Under new currency restrictions, banks must show that all transactions of more than $100,000 are fully backed by documentation for the customs clearance. SAFE also said that it will closely monitor any transactions of more than $200,000.

Wu said that Beijing had "lost several billion U.S. dollars" through fake customs documents so far this year alone. "Such a disorderly capital flow is destructive to China," she said. "These kinds of transactions have intensified pressure on the foreign exchange market and have had a negative impact on China's balance of payments and the stability of the yuan exchange rate." She said that illegal holding of foreign exchange was responsible for the lack of growth of China's reserves, which had been growing at a double-digit rate in previous years. Wu said that Chinese citizens also hold about $80 billion in foreign exchange in the country, not counted in foreign reserves, and that that money could also get out of the country if controls are not tightened.

In September, SAFE had banned foreign companies in China from borrowing renminbi to pay off foreign-currency loans before they are due. The regulation was made to ensure that China's four big "policy" banks will have sufficient funds in order to support the government's infrastructure program. The policy banks have been directed to purchase 100 billion yuan in new government bonds issued in August, to fund infrastructure development. In addition, the ceiling on domestic lending was raised by 100 billion yuan, to 1 trillion yuan, to provide new loans to rebuild after the floods.

Foreign companies had previously borrowed renminbi from Chinese banks to pay off their foreign-currency loans before they were due, in an effort to "hedge" against a possible devaluation of the renminbi, the *Financial Times* had reported.

Price controls are also being imposed on machinery and equipment manufacturers, to prevent enterprises from selling below cost. The competitive, under-priced selling has forced many enterprises to lay off workers. Products affected by the price floors include computerized machine tools, automobiles, trucks, and power-generating equipment.