China's float may pop the financial bubble

by Michael Billington

The Chinese government's decision to let its currency (the yuan) float freely as of Jan. 1, in line with the demands of the International Monetary Fund (IMF), the General Agreement on Tariffs and Trade, and the "friends" of China such as Milton Friedman, is likely to provoke a near-term currency crisis which could burst the bubble both in China and in the Hongkong financial control center for global speculation in the cheap-labor pool on the mainland. The official rate of 5.8 yuan to the dollar was devalued by 33% to 8.7 yuan to the dollar, equal to the "swap" rate at which certain foreign and privileged companies were previously permitted to exchange their currencies. At the same time, the "third" currency, the Foreign Exchange Certificates, issued only to foreigners but increasingly used as an accepted currency (trading between the official and the swap rates), was eliminated.

The People's Bank of China, which is becoming a central bank along the lines of the U.S. Federal Reserve, announced that the new unified rate would be allowed to float, with the only control mechanisms being bank intervention in the market and currency exchange controls. Although the yuan has still not been made convertible, it will now be easier for domestic financiers, backed by illegal funds from the likes of George Soros and the Hongkong dope banks, to try to manipulate a big slide in China's currency. Worse, foreign bankers are clamoring for Beijing's foreign exchange controls to be lifted altogether, making the yuan freely convertible like the Mexican peso, so that foreign banks can begin massive bank operations in Chinese currency and capital flight.

An edict to ban the circulation of foreign currency was issued by the People's Bank of China, but was quickly modified by an announcement that the Hongkong dollar will be accepted as legal tender in the South. Some 30% of the currency of Hongkong, which is pegged to the U.S. dollar, already circulates on the mainland, primarily within Guangdong province. The Taiwan dollar is also virtually legal tender in Fujian province. Beijing has not been able to control credit generation in these areas, since Hongkong interests bypass Beijing by issuing Hongkong dollar credits.

In December, the *Hongkong Standard* reported that China had officially *agreed* to allow the Hongkong dollar to circulate freely in the Special Economic Zones of Shenzhen and Zuhai. This acknowledgment of the existing reality was seen as a step toward full convertibility of the yuan. Also, the Bank of China recently joined the Hongkong and Shanghai Banking Corp. and the Standard and Chartered Bank as an official *issuer* of the Hongkong dollar, in preparation for China's takeover of Hongkong in 1997.

Other emergency measures were announced to try to prevent panic and rein in inflation, which is over 20% per annum in the cities, the highest in five years. Price controls were reimposed on basic foods after a 30% leap in grain prices earlier in December. Import restrictions were announced Dec. 31, aimed at both preserving foreign reserves and protecting national industries, especially machinery and electronics. However, the United States is demanding that China *increase* its imports to reduce the positive balance of trade that China enjoys with the U.S. due to the massive textile and other light industry exports. China's mild efforts to protect its heavier industries will likely meet with U.S. countermeasures.

The end of the two-tier currency rate has dealt another blow to the already endangered state sector, which comprises most of China's heavy industry. These firms were allowed to purchase hard currencies at the official lower rates, which functioned as a form of subsidy. New regulations were issued simultaneously, providing state sector firms the "right" to fire their employees. The guaranteed right to a job (the "iron rice bowl") for the critical but shrinking layer of skilled industrial labor is crumbling. The IMF has repeatedly blamed all economic problems on the "inefficient and overstaffed state enterprises," proposing that they be privatized and stripped down in size—a prescription which has destroyed the productive economies of Russia and eastern Europe.

The other dramatic economic reforms announced at the Third Plenum in November are also being implemented, although their effectiveness will not be measurable right away. These include: a new tax system, which is aimed at forcing the southern provinces to send more money from the speculative boom into the Beijing coffers, new investment banks in agriculture, industry, and for export-import, which will be responsible for state support for production and trade; an "independent" central banking system; and a vastly expanded market in stocks, gold, and currencies.

Shanghai reemerging as a banking center

Shanghai is reemerging as the center of the new "socialist market economy" in China, and many foresee it regaining its pre-communist-era role as the hub of Asian finance. As Reuters reports: "It is no coincidence that the new [foreign exchange] trading floor will be situated in a mansion that housed the former Central Bank under Kuomintang rule." In fact, such mansions date back to the virtual British colonial rule in the 19th century. The banking houses which have served as government offices under the communists are being sold back to their original owners, such as the Hongkong and Shanghai Banking Corp. and the Swire group. Those in London and New York who view these developments as more than symbolic are more than willing to provoke chaos in order to carry out their policies.