A sign of a fragile economic system

China's first major financial bankruptcy

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China's first major bankruptcy of a financial institution--the Guangdong International Trust and Investment Corporation (Gitic) in mid-January--underscores the fragility of the country's financial system and the likelihood of further major restructuring and closures as the growth rate continues to decline.

Gitic, which was formed in 1980s as a means for attracting foreign investment to Guangdong province, was first closed and put into the hands of a liquidation committee last October. The corporation was declared bankrupt at a meeting of investors on January 10 with debts to the tune of $US4.5 billion.

International banks and financial institutions reacted adversely to the decision by the Chinese government not to intervene to prop up a corporation which many believed had been guaranteed by its immediate owner, the Guangdong provincial government, and therefore by Beijing itself.

The liquidation committee established by China's central bank, the People's Bank of China, also announced that 25,000 individual creditors would be paid before banks and foreign investors. Committee head Wu Jiesi said: "To my knowledge, China's bankruptcy law does not provide for priority for foreign creditors." Almost half of the $4.5 billion is owed overseas.

The crisis worsened a few days later when it was revealed that a second major investment company--Guangdong Enterprises (GDE)--was facing insolvency with liabilities of $US3.2 billion. At a meeting on January 12, about 400 representative of 80 bank creditors learned that the injection of more than $300 million by the provincial government had failed to solve its financial problems. Goldman Sachs is already overseeing the restructuring of GDE, which has substantial interests in brewing, building and tanning. Now the company is asking its creditors for a stay of three months on its principal loan repayments.

China has 240 non-bank investment houses or Itics, many of which are in financial difficulty. The Guangzhou International Trust Corporation (Gzitic), the investment arm of the Guangzhou, the provincial capital of Guangdong, is reported to be under pressure from creditors to repay $US35 million borrowed to finance a chemical plant. The Dalian International Trust and Investment Corp (DITIC), has also defaulted on loan repayments and has overall borrowings of over $2 billion.

A number of economic commentators have warned that the Chinese government will allow the number of such investment houses to fall to 70 or even less. The exposure of foreign financial institutions to Chinese Itics is estimated to be between $10 billion and $15 billion. The financial problems of these non-bank finance corporations points to an even more fundamental underlying crisis of the banking system as a whole. According to some commentators, the level of bad loans held by China's state banks amounts to $212 billion or 25 percent of all lending.

It is no accident that the debt difficulties have emerged in Guangdong. Over the past two decades the province bordering Hong Kong has been a hothouse of capitalist development. Overseas companies have signed 200,000 contracts and provided at least $80 billion in investment, more than one third of the national total, in order to exploit the opportunities of establish cheap labour manufacturing enterprises. More than 11 million migrant workers from poorer inland provinces have flooded into the area to live in crowded dormitories and work under atrocious conditions.

The economic boom in Guangdong has provided plenty of opportunities for local bureaucrats and entrepreneurs to act as middlemen and to cash in on the associated speculation in property and shares. The provincial government has also been able to gain a measure of local autonomy through Gitic and other investment houses from the national government. One of Beijing's reasons for closing down the Guangdong corporations is to reassert its own control over the economy. The initial decision to shut down the Guangdong International Trust and Investment Corporation came after a visit to the province by the Chinese Premier Zhu Rongji last October.

But the financial instability is part of a broader crisis stemming from the economic recession throughout the rest of Asia, and internationally. China's exports to Asia have slumped as a result of the downturn in the region. Furthermore, it is now having to compete with cheaper goods manufactured in countries like Indonesia and Thailand where the value of the currencies have fallen markedly. Under pressure from the US, Japan and other powers, China has not so far devalued its currency in a bid to cheapen its exports.

China's official economic growth rate fell in 1998 to 7.8 percent and is expected to be even less this year. Some commentators, however, claim that the official figures are inflated and estimate last year's growth at only 5 percent. The economic slowdown has undermined the frenzy of speculation and threatens to trigger off further financial collapses in China and neighbouring Hong Kong, which has acted as a funnel for foreign investment into China. The value of the so-called Hang Seng Red Chip Index on Hong Kong's stockmarket--a measure of the value of mainland stocks--fell by a massive 48 percent during 1998.

Over the last two decades, the Beijing bureaucracy has moved rapidly to open up the Chinese economy to international finance capital and to encourage the growth of private enterprises. Over the next year, the government plans to shut down many of the country's state-owned industries, throwing millions of workers out of work. The collapse of Gitic and other major finance houses will further accelerate the economic and social crisis.