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Fifty Years of Socialism in China: From the Self-Assertion of a Communist Regime to the New "Middle Kingdom"

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Introduction

In Western democratic countries, people act on the basis of a well-established law which sanctions the interests of private economic subjects, because the nation-wide validity of their business activities has already been absorbed in the state's purpose of promoting the growth of its economy. The practical implementation of an established law is the task of judges and lawyers. In the performance of their job, the politico-economic causes behind the establishment of law and legal systems are not their business and, as a rule, do not interest them much.

In China, the decision of the leadership of the Chinese Communist Party (CCP) to transform their planned socialist economic system step by step into a market economy has had fundamental consequences for all spheres of society. The efforts of the party leadership have been directed towards nothing less than the creation of private economic subjects who, while pursuing their private economic interests, at the same time promote the economy of the Chinese state. In order to fulfil the new purposes of China's socialist market economy, a gradual transformation of the complete legal system was required – consequently, the constitution had to be fundamentally amended and a complete corpus of new laws be established which would sanction the new politico-economic purposes of the state. Basic new laws were built up and implemented during the 1980s. Many laws had to be amended during the 1990s and numerous new ones enacted. At this point, not only economic and commercial laws, the legislation of which has been of major importance in the initial years of the reforms, were introduced; civil, social, administrative, and criminal laws have now also been established and improved. Members of the CCP themselves emphasized in the Central Committee:

> "Wang Jiafu said the establishment of the socialist market economy's legal system is far from being merely the repairing of the former legal system, it constitutes a profound and far-reaching reformation of the legal structure. It unites the socialist market economy, provides it with legitimation, establishes the first legal system world-wide of a socialist market economy, and possesses an epoch-making significance. ... Looking at the experiences of every country in the world, especially those of the developed countries, taking account of the necessity of the healthy development of the socialist market economy of our country, a sound and complete legal system of the socialist market economy should above all include and deal with five legal sections of law: civil law, commercial law, economic law, social law, administrative law, and criminal law. ... The implementation of the socialist market economy law naturally requires the obedience of all citizens, of all legal individuals; however, the crucial point is obedience to the law of the leaders at all levels, the strict execution of the letter of the law by all executive organs, and the strict adjudication of all judicial authorities."[1]

The driving factor behind the CCP's decision to introduce a socialist market economy with the concomitant legal systems in its territory, has, conversely, perhaps not always been so clear. Generally it may be said that the CCP had "discovered" that in the present global political and economic situation a market economy would be better, i.e. more efficient, for China, if it is to take its place among the successful participants in the world market. But the crucial point behind this "realization" of the CCP, i.e. efficient in relation to what, has never been pronounced in as many words. In this respect, it is striking that the CCP had at a very early stage already measured the different political systems according to the criterion of which would be the most appropriate to promote the development of China and to establish a unitary state. Both Mao Zedong and Deng Xiaoping repeatedly emphasized that the "capitalistic way" with, for example, civil liberalization such as in Western democracies, would have meant chaos and destruction if applied to China.[2] But compared to the first half and the first decades of the second half of the 20th century, the world-wide situation has changed tremendously. Under the decisive influence of Deng Xiaoping, in the late 70s and early 80s the CCP gradually changed its mind about which way was the most appropriate one. Meanwhile, the CCP has undertaken a great deal to establish new ways of doing business – it even seeks to "run" Hongkong as one of the world's financial centres, continuing the role it played before the takeover by China.

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1 *Renmin ribao* 21.01.1995. Reprinted in Xiao Yang (ed.), *Shehui zhuyi shichang jingji fazhi jianshe jiangzuo* [Lectures on the Establishment of Legal Systems in the Socialist Market Economy]. Beijing: Zhongguo fangzheng chubanshe 1997, pp. 420–421.

2 For a brief comparison of Mao Zedong's and Deng Xiaoping's idea of establishing a unitary state and industrializing China cf. Angela Schottenhammer, "Deng Xiaoping und der 'Sozialismus chinesischer Prägung'", *Asien*, No. 61, 1996, pp. 70–79.

But with all the decisive changes in China's economic, social, and legal system, one feature remains constant: all the changes and reform measures are implemented under the premise of whether they are advantageous or harmful to China – sometimes, however, the eventual consequences cannot be foreseen.

The present article seeks to explain the main steps of this politico-economic transformation process. Special emphasis will be laid on aspects which have hitherto been rather neglected in articles treating the history of this process, or, have been explained incorrectly. In this context, the decision of the CCP to use money and credit as a means of state development, as is done in Western market economies, will be explained more thoroughly, because in the momentary stage of development the monetary sector, the introduction of a stable national (credit) money[3] as a motor for economic growth, constitutes a major component of China's transformation process and has particular consequences within an internationalized global economy. And in contrast to Germany after the 2nd World War (cf. footnote 3) there is no successful market economy which is willing to back the Chinese money, the Yuan, with its stable and creditworthy currency. In this respect, it is also very important to note that the eventual goal of the reformers is to create a national currency which would represent wealth beyond the borders of China on the world market and would consequently open the way for Chinese "money owners" to obtain access to foreign wealth. China plans to create an internationally demanded, stable national currency – the decisive economic weapon in today's global economy. This intention characterizes China's monetary policy towards Hongkong, its system of "One Nation – Two Currencies", which constitutes in fact a novelty in the history of political economy and will therefore be examined too.

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3 The modern bank notes are "credit money" because – in contrast to historically used valuable metal coins – they do not have intrinsic value, but "receive" their "value" only by a government act of sovereignty; the government issues a national currency as the only valid national tender and binds everybody in the country to earn this money. By so doing the government wants to instigate business activity and production, although real values do not (yet) exist. In this sense, the modern bank notes are a form of credit for the future production of real values. For a better understanding a comparison to the introduction of the German Mark (DM) after the 2nd World War may be helpful: The DM "received" its value only through, first, the backing by and the convertibility with the US Dollar (4.2 DM = 1 US Dollar; Marshall Plan) as an already successful, creditworthy national currency and, second, by means of the sovereign act of the new German government (a consequence of the decision of the USA to have Germany built up as a front nation against the Soviet Union) to have it established as the only valid national tender which everybody was obliged to earn resp. to increase. And it is no secret that a pure credit in DM as the new currency would have been of little use, if it was not backed by the US Dollar, at that time the only worldwide creditworthy currency, thus the equation of "the US Dollar is equal to gold".

As the relations between the state and its economy and the state and its society had to be radically rearranged first to achieve this goal of changing the purpose of the Chinese economy fundamentally – an aim which found its expression in and was based on the extensive amendment of the constitution in 1982 – and because the transformation of legal regulations corresponds to the need for new politico-economic goals and to the consequences these have for the economy and society of China, the major constitutional changes will be treated as well. This includes a brief analysis of the fundamental change of China's constitution and of major legal consequences of the transformation process – i.e. elucidating why the decision of the CCP leadership to transform its economy and society from a socialist planned economy to a socialist market economy required the introduction of new legal systems. It is not intended to provide the reader with a survey of the concrete content of all the new legal regulations which were or are now in force.

Law and Constitution before the 1980s

In 1949 the Chinese Communist Party (CCP) established the People's Republic of China (PRC). The new government did not adopt the model of the separation of power, which had prevailed during the previous period of the Republic of China (1912–1949). "The Directive of the Central Communist Party concerning the abolition of the Kuomindang's Complete Book of Six Major Laws and Establishing the Court Structure in the Liberated Area" was promulgated in February 1949.[4] The document confirmed that 'law was supposed to be an instrument of class rule and called for the socialist judiciary to operate in accordance with the new laws and policies promulgated by the government, the CCP, and the People's Liberation Army'.[5]

The first constitution was laid down in 1954 under the chairmanship of Mao Zedong.[6] One of its characteristics was that, instead of "constituted" state principles and laws on how to regulate and administer society, it contained a programme according to which the Chinese state and economy had

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4 *Guanyu feichu Guomindang de liufa quanshu yu queding jiefanqi de sifa yuanze de zhishi*, February 1949.

5 Yong Zhang, 'An Overview of Legislation and its Supervisory System in China', Yong Zhang (ed.), *Comparative Studies on the Judicial Review System in East and Southeast Asia*. The Hague, London: Kluwer Law International 1997, pp. 101–132, p. 106.

6 "Constitution of the People's Republic of China from 1954", Günter Franz (ed.), *Staatsverfassungen. Eine Sammlung wichtiger Verfassungen der Vergangenheit und Gegenwart in Urtext und Übersetzung*. Dritte durchgesehene Auflage. Darmstadt: Wissenschaftliche Buchgesellschaft 1975, pp. 96–117.

to be established. It declared the people to be the rulers of the country, exercising their sovereignty through the National People's Congress, which consisted of their indirectly elected representatives. The Executive (State Council), the Judiciary (Supreme Court), and the Supreme Procuratorate were ancillary organs of the National People's Congress (NPC). Their heads were appointed by and responsible to the NPC. One important aspect of this constitution was the much cited unity of state, party, and people ("the people are the rulers of the country"). This idea of a unity at all levels and echelons of society was expressed in various articles (Sect. I, Art. 17, 18) theoretically binding, for example, the party leaders' decisions to the desires of the people. Had this kind of unity between party leaders and the people in fact existed, any moral, and legal accentuation or codification would have been unnecessary and obsolete. Another important characteristic was that the NPC was regarded as the sole legislative body. Until the end of the 1970s, China did not enact any basic codes to cover criminal or civil law legislation. And even though many legal norms were issued by the State Council and the organs of the government at different levels, they could not be regarded as administrative laws in the modern sense, since they were created to operate in the planned economy and, therefore, did not provide methods of enforcement, but only imposed one-sided duties on enterprises and citizens.[7] The second constitution dates from 1975, the third from 1978; they were officially designated "Great Cultural Revolution Constitutions".

This is why this first constitution was never really relevant to actual political decisions. Governmental activity was not determined by objective laws or rules, but by the political decisions of the CCP, i.e. according to the successfully asserted "party will" which was carried out by the heads of government and the administrative agencies. The CCP planned the economy and other sections of society. Any dissatisfaction arising among the people was made the responsibility of relevant party members and more often than not was made the object of moral campaigns. Offences against what was regarded as "socialist agreement" were punished by criticism and self-criticism and re-education campaigns, or with even more severe penalties such as the death sentence. Law and legal systems like in a modern market economy did not exist in China under Mao, because they were not required by the politico-economic purposes of the CCP.

7 Yong Zhang, 'An Overview of Legislation ...' (1997), pp. 106–107.

Constitutional Changes in the 1980s and '90s

The decision to transform Chinese society from a socialist planned economy to a socialist market economy was first initiated by the Third Plenum of the Eleventh National Communist Party Meeting in 1978. The subsequent transformation required fundamental changes in China's legal system. In contrast to Mao Zedong who had insisted on the unity of state, party, and people and had organized a modest livelihood for the people, the new political line, with Deng Xiaoping as the most famous promoter and motor of the reformation programme, considered Mao's idea of organizing society to be highly inappropriate for attaining higher political goals. In Deng's eyes as well as those of his followers China would do better to adopt market economy strategies, if it wanted to develop into a great, not simply in economic terms, power in the world. From studying successful Western countries, the reformers had learned of the material and financial means a market economy could provide the state. Consequently, they sought to shed the state's obligations towards its society; reversing the situation, they wanted society to become an efficient economic system from which the state could eventually profit in financial terms. The decisive impulse to push ahead with further development was the "enrichment slogan" issued by the reformers in the CCP. The request to the people to enrich themselves reflected the party's interest in creating economic growth within society and was at the same time a confession that within the system of a planned economy hitherto pursued the spur for people to seek wealth had been lacking. This is not surprising. After all, in an economy in which the state fixes the prices, distributes the financial and material resources to its enterprises, guarantees the purchase prices for food and so forth, how could a desire for this kind of personal enrichment burgeon? The Chinese money, the "people's currency" (Renminbi) had functioned purely as a mechanism for reckoning the balancing of accounts between the enterprises and the state, and as a means of circulation between consumers and producers. The goal of earning and accumulating money as an abstract expression of wealth was alien to Chinese society under Mao. To re-awaken this interest among the people, the CCP issued its famous enrichment slogan and partially relaxed price control, initially only in the agricultural sector, but gradually extending this to industry. This partial release of price controls was a first major step in the reformation and reorientation of the purpose of the Chinese economy.

In order to achieve this goal of changing the purpose of the Chinese economy fundamentally, the relations between the state and the economy and the state and society had to be radically rearranged. In 1982 the constitution was extensively amended. The preamble to this constitution declares the constitution to be the fundamental law of the state, which possesses supreme legal authority. No law, no administrative regulations or local rules shall contravene the constitution (Art. 5, Sect. 2 and 3). Changes to the constitution could be construed as a declaration of the intention of the party leadership to alter and reform its political and economic purposes. The ideal situation envisaged was virtually re-enacted in the constitution. The party leadership did not simply change its political and economic goals, but raised its own claim and intention, independent of its position as CCP leadership, to the status of an objective state programme – expounded in the constitution. This is in fact the reason why such constitutions have never been regarded as "real constitutions" in Western democracies. In practice, readjustments to and reformations in Chinese law and legal regulations have always appeared as a kind of response to situations, developments, and circumstances in society caused by the gradual reformation of its economy, and in this respect had in fact built up a certain momentum.

In 1986 the NPC passed two new statutes, the "Regulation of Punishment in the Public Security Administration" (RPPSA) and the "Land Administrative Act" (LAA), which may be regarded as a state legal reply to the problems which had arisen in certain areas of society. Under the RPPSA, public security agencies were empowered to handle and decide administrative punishments and compulsory measures to protect the citizens' legal rights and maintain the social order. The parties involved were allowed to raise complaints and sue the public security agencies, if not satisfied with their decisions. The LAA provided land administration bureaus with the competence to judge disputes about the right to land ownership and land use between different parties (between the government and a group, a group and an individual, and between individuals). Every party was given the right of complaint and could even bring the case before a law court, if dissatisfied with the decisions. Since this statute was introduced, the number of cases has increased rapidly, in 1987 suddenly climbing to about 6,000.[8] Furthermore, the land administration bureaus were empowered to prosecute violations of the LAA.

In 1988, the Constitution was changed again. In Article 11 the newly amended Constitution officially allowed individuals to undertake private business and granted the protection of the legal rights and interests of private business.[9] This coincided with a reform of state-operated enterprises.

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8 See Lao Haocai (ed.), *The Judicial Review System in China*. Beijing: Beijing University Press 1993, p. 566.

9 The Constitution of 1982 (§ 8) did not yet officially allow private business. Only workers who were members of rural economic collectives had the right to farm plots of cropland and hilly land allotted for private use within certain limits.

In 1993, another constitutional amendment was made. The 1993 Constitution officially laid down such economic principles as the adoption of the "socialist free market" (§ 15), the strengthening of legislation in the economic sector (§ 15), the transformation of a state-operated economy into a state-owned economy (§ 7), the guarantee of the right to self-operation of enterprises (§ 16), and other such measures.

In this way, the CCP has step by step transformed its economy from a centrally planned to a market economy allowing for the growth of more and more private business. To initiate and guarantee this new economic goal, the CCP had also to reform the legal framework in society and adjust it to the exigencies of a "socialist market economy". In the beginning, only farmers were permitted to cultivate a small piece of land privately and to sell their produce freely in the markets. By now, the CCP considers China to be a suitable country for investors and is obliging the whole of Chinese society to espouse the use of "free enterprise" methods. However, the CCP always has to take into account that the installation of a new economic system with a new economic goal – to earn money – is tantamount to the destruction of the hitherto prevailing planned economy. This means that the CCP has to deal not only with new "legal cases" in society arising from new social, financial, economic and other relations, it has also to be cautious not to ruin its national economy completely, as happened in Russia, and to ensure that there are respective preventive measures. Therefore, the legislation for statuary laws which lay down the new relationship of rights and duties between the government and its citizens and between the citizens themselves has also been developed. And with China's involvement in the world market, amended former legal systems or newly created laws also had to be adapted gradually to "international standards". In order to improve and carry through its political goals, in May 1997 the CCP took the step of passing a law on "administrative supervision", comprising legal requirements detailing the organization and competencies of supervisory authorities.[10] But let us first trace back the developments which required the establishment of numerous laws and legal regulations in more detail.

Special Economic Zones as a Test-case for the Transformation into a Market Economy

As China did not yet have the financial means to instigate flourishing free market business, the reformers decided that the first necessity was to attract

10 *Fazhi ribao*, 10.05.97.

foreign capital and technology to help to develop China on its road to capitalism. They sought to use foreign means to provide China with part of what they still lacked and thereby become a more highly developed country even faster, but were not so naive as to believe that foreign countries would simply provide China with all it required through sheer altruism. By taking the political step of opening China to foreign investment, in practical terms the CCP exposed China to the critical gaze of international money investors, who, as a rule, astutely select the most profitable opportunity to invest their money and technology. The CCP knew that China had to offer good conditions. To acquire the necessary attractiveness of location and at the same time to protect the greater part of China from the negative consequences of market regulations on its planned economic system, the reformers created completely separate economic zones, primarily located along the more highly developed south-east coast, detached from the rest of the country. In May 1979 "The Initial Plan for Conducting Pilot Zones for Exports in Shenzhen, Zhuhai, and Shantou" was proclaimed and in July the "Party's Central Department of State formulated a special policy in Guangdong and Fujian Provinces".[11] Then the CCP equipped these "free market islands" with the conditions most essential to business life (from industrial infrastructure to telephone networks etc.) at its own expense, i.e. at the expense of its national planned economy. The latter had to find and provide the means necessary to develop these special economic zones (SEZ) even more, virtually as a preliminary advance outlay. The SEZ were also fed with cheap products from the planned economy. Adding to the bait, foreign investors were exempted from most of the usual taxes. One major argument in the bid to attract foreign money were the extremely low wages, compared to Western standards. Cheap labour was undisputedly one of the prime incentives China had to offer foreign companies. And as long as the Chinese workers still had recourse to the benefits and services of the planned economy, their wages were not even a pittance of that paid in other Third World Countries.

With the relative economic success of the SEZ, the CCP gradually changed its policy and slowly also exposed the rest of China to market reforms. At a meeting of the Central Secretary Office and the Department of State held from 16 March to 6 April 1984, the decision was taken to open another fourteen coastal cities.[12]

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11 See Jung-Dong Park, *The Special Economic Zones of China and their Impact on its Economic Development*. Westport, Connect.: Praeger Publishers 1997, p. 3.

12 Jung-Dong Park, *The Special Economic Zones of China* ... (1997), p. 5.

The Reformation of Enterprises

Reforms during the 1980s and the First Half of the 1990s

The CCP no longer intended to run the industrial sector as before. It wanted to get rid of the obligation to provide its enterprises with investment aids and material resources, and it wanted to shed the responsibility of organizing the food and other provisions of its employees. It sought instead to create an economy in which enterprises were separate from the state, which implies that they themselves were responsible for costs and profits. By so doing, the central government thought it would be able to relieve itself of its responsibility for its economy. In order to establish such an economic system, the first step the government took was to detach its economic units and introduce the idea of private property, concomitantly with the essential rights of disposal over the means of production in order to enforce the validity of this concept. The reference numbers so far used to judge whether or not an enterprise had realized the planned target, were substituted by the decisive reference number called 'profit'. Profit made was heralded as the self-interest of the now "independent" enterprises, aimed at providing them with the stimulus to try hard to make a profit without being forced to do so.

Profits now no longer have to be delivered to the central authorities, but are taxed. The reform of the tax system occupied an overriding place in the economic reform. The most important point was the levying of income tax on state-owned enterprises instead of requesting them to hand over their profits. In December 1993, the State Council promulgated an announcement that it approved of "the implementations of a plan for the reform of industrial and commercial taxes", pointing out the defects of the former taxation system. This reform was carried out in two steps. The first of these was to test the system of imposing an income tax structure. The second was to divide industrial and commercial tax into a turnover tax (or goods tax), a value-added tax (VAT), a salt tax, and a business tax; to establish income tax and a regulatory tax, a resource tax, a town maintenance and building tax, a real estate tax, a land usage tax, and a car tax.[13] In short, a new turnover tax system had been introduced consisting of value added tax, consumption tax, business tax, resources tax, agricultural tax, and tariff tax, officially based on the principles of equity, neutrality, transparency, and universality.[14] The scope of the VAT was extended to the total industrial

[13] Yong Zhang, 'An Overview of the Chinese 1993 Tax Reform and its Perspectives', Yong Zhang (ed.), *Changing Tax Law in East and Southeast Asia towards the 21st Century*. The Hague, London: Kluwer Law International 1997, pp. 35–72, pp. 38–39.

[14] Yong Zhang, 'An Overview of the Chinese 1993 Tax Reform ...' (1997), pp. 42–49.

process and to wholesale and retail sales. Two brackets were established, the higher rate being 17 % and the lower 13 %. The lower rate was mainly applied to basic foods and agricultural products. VAT was also applied to all enterprises, institutions, and individuals both domestic and foreign. The number of items exempted from taxes was gradually reduced.[15] Because the taxes on many commodities had actually been decreased after the introduction of the VAT, a consumption tax was brought in in order not to lose larger amounts of tax revenue. Besides this, so-called luxury items such as cigarettes or jewellery were included in this consumption tax. Business taxes were imposed on business transactions which were concerned with the sale of services, i.e. transportation, construction, financial insurance, post and communications, culture and education, amusements and services, addition to the turnover of intangible property and the sale of real estate. These business taxes were exempted from VAT.

The amortization funds of the state enterprises were no longer administered centrally, but now formed the capital of the "newly established" enterprises and were to be used by them to do business and improve their income. In the course of this reformation, former socialist "managers" of state enterprises became "profit commissioners" of the state. To be successful they were vested with more legal competencies towards their employees and were allowed to decide about the use and investment of the profit they made.

One important characteristic of this Chinese reform programme is that – because in socialist China there were no echelons existing in society who in their own private interest would naturally respond to the CCP's order for profit making – the CCP appointed the former heads of the socialist enterprises to be part managers in its service, and part to be "tenants" who, along with their position as managers of an enterprise, acquired the right to become "capitalist company owners" via the profit they made. It was assumed that new enterprises could and should be founded, initially by existing economic units and government authorities, and eventually by anyone who had earned money enough to invest. Disappointed by the consequent rise of (ab)uses by these newly appointed enterprise managers, the CCP repeatedly complained about "economic corruption" and eventually passed a law against "unfair competition".[16]

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15 Before the reform the VAT was not imposed on the total process of industrial production and a 12 bracket tax rate had been set up, the lowest rate being 8% and the highest 45%. See Yong Zhang, 'An Overview of the Chinese 1993 Tax Reform ...' (1997), p. 43.

16 See for example *China aktuell*, No. 5, 1994, p. 509. *China aktuell*, No. 6, 1993, p. 561. As for the necessity of corruption cf. Angela Schottenhammer, "On the Necessity of Corruption amongst the Members of the Chinese Communist Party", *IIAS-Yearbook* 1995, pp. 61–71.

To be able to make a profit, the new managers also had to be given the permission to change the treatment of their employees. Workers now had to be employed only when their employment promised to be profitable to the enterprises. The economy was now supposed to pay for work only when employment of labour could yield more profit than it cost. The making of profit measured in the form of money became the condition for employment, which had to produce what was required. Because the CCP was well aware of the negative consequences all these reforms had for many workers, they were, of course, not introduced in one go, but step by step. Already now the results are glaringly obvious: at the end of the year 1996 almost 6 million people were unemployed and another 22 million were registered as superfluous workers in state enterprises. In view of this problem the CCP had to issue legal directions to enterprises, setting out the minimum social obligations they had to meet in order to prevent the worst consequences of the reform.[17] By May 1997 many enterprises were said to be intentionally trying to be declared bankrupt, as the government had introduced a legal regulation that bankrupt enterprises would receive some financial support for dismissed workers and for repaying their debts.[18] Again, this situation required many new legal regulations. Not only in the sense that the "socialist right to work" had to be abolished, which is easily done; most importantly, the revamped enterprises and their managers had to be put in the position to hire employees according to their business calculations, and when their work was no longer profitable to the enterprise they had to be vested with the right to "get rid of them" without incurring greater problems. In this context the basis for a labour law was created.

Acceleration of the Privatization of State Owned Enterprises in the Second Half of the 1990s

The 15th General Meeting of the CCP in September 1997 finally gave green light for the privatization of state enterprises.[19] 120 enterprises, comprising about one quarter of the entire state sector, have been selected by the government as pilot enterprise groups. These enterprises have acquired more competencies and rights for decision-making in the field of management and deal with import and export matters. Furthermore, they are to be allowed to issue stocks and promissory notes to improve their financial situation. Simultaneously, the government has sought to reduce investments in their state-owned enterprises. At the local level, the reformation is being

17 *China aktuell*, No. 5, 1997, pp. 422–423.

18 *China aktuell*, No. 5, 1997, pp. 421.

19 *China aktuell*, No. 9, 1997, pp. 843–846.

realized through bankruptcies, mergers, and the issuing of stocks on the stock market. It goes without saying that such procedures raise many legal questions, for example concerning ownership rights, or basic conditions for the issuing of stocks, for mergers and the like, and therefore require many new legal regulations.[20] Meanwhile, by 1999, private enterprises which had so far only been functioning complementary to the socialist organized economy have been classified as the most important elements of the Chinese economy by Zhu Rongji. And the consequences of this privatization wave are by no means negligible – newspapers speak of up to 170 million people becoming unemployed by the end of the year 2000.[21] Under such circumstances laws dealing with the social support and protection of workers have been enforced, too.[22]

The basic idea behind the move to accelerate the privatization of state enterprises was to transform indebted state enterprises into joint-stock companies which would consequently provide the enterprises with money and minimize the debts accumulating in state and bank accounts. In reality, however, the transformation of debts into stocks only meant the exchange of old debts for new ones. And whoever bought these stocks consequently accumulated (these) new debts. When the CCP prohibited its banks from buying such stocks newly issued by the enterprises, this could well be taken as an indication that the CCP was well aware of the fact that these stocks do not represent real wealth, but simply a guise for debt. Nor can the legal prescriptions for managers, the establishment of a modern management system, and the repeatedly emphasized legal distinction between owners of enterprises and managers[23] – i.e. between the legal private ownership of the means of production and its economic functioning – circumvent this principal dilemma that it is debts (credit and stocks) which are supposed to produce real wealth, real money. Within China the CCP has been experiencing difficulties in solving this problem. Therefore it hit on the idea of placing these stock titles in Hongkong, a financial centre with legal systems established by the British, where real wealth already abounds. But before I expound on the politico-economic consequences of the return of Hongkong to Chinese sovereignty, the principal characteristics of the creation of the credit sector should be explained first.

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20 As it was, for example, a lucrative option for highly indebted enterprises to merge with those which made profit, such actions had to be prohibited by law as 'offending against the laws of the market'. *China aktuell*, No. 10, 1997, p. 969.

21 *Frankfurter Rundschau*, 16.03.99.

22 *China aktuell*, No. 3, 1997, p. 222. *The Asian Wall Street Journal* (hereafter *AWSJ*), 01.05.97.

23 *China aktuell*, No. 3, 1997, p. 222. *China aktuell*, No. 9, 1997, p. 844.

The Creation of a Credit Sector

When starting to reform their enterprises, the reformers found out very quickly that an industrial sector which is responsible for finding its own financial means independent of the state, needs credit. In order to give the national economic accumulation an initial impetus, investment and the founding of a company may not depend on how much money a future businessman has already been able to earn and accumulate – especially because such an accumulation of wealth (money) was, as a rule, simply not possible under the former socialist economic system. Consequently, it is not the amount of money a company has already earned and accumulated which has to be the decisive factor of whether or not a business transaction is to be carried out. Instead, the possibility of and opportunity for earning more money than has been invested – the speculation on *future* business success – has to become the decisive determinant of whether there is enough money for a business transaction or not.

The first step (1978–1984/85) for raising credit was the transformation of the People's Bank of China (PBC), the former planning instrument for the funds supplied to the government enterprises, the authority to manage accounts and redistribute financial means, into a central bank with the functions and characteristics typical of such an institution in a market economy. The CCP intended to establish a central bank which, ideally functioning in a way similar to an institution such as the German Bundesbank, would take over the role of a "macro-economic control mechanism". This transformation spelled the annulment of the bank's direct relationship with a state-planned industry. Instead, the central bank found itself in a relationship with newly established business banks in which it lent sums of money at certain rates of interest.[24] In what amounted to an injection of cash, the new Central Bank transferred part of its accumulated saving deposits to the business banks, sums which those needed to form a financial account basis. Having been provided with these accounts, they were expected to manage their business according to private economic principles, which meant that

[24] From 1984 to 1994 the CCP gradually introduced a dual bank system consisting of the PBC and of 4 state-owned specialized banks (SOSBs: Bank of Industry and Commerce, Agricultural Bank of China, Bank of China, and Construction Bank of China) which were eventually transformed into state owned commercial banks (SOCBs) in 1994. In addition, several other national and regional commercial banks and particular "political orientated" banks (Agricultural Development Bank, Import and Export Bank of China, State Development Bank) were founded. Cf. for example Xu Xiaoping, *China's Financial System under Transition*. London, New York 1998. Cheng Enjiang, Cheng Yuk-shing, "Banking Reform and the Separation of Policy and Commercial Loans in China", *MOCT-MOST* 8, 3 (1998), pp. 5–21.

they should pay heed to their own potential for profit by lending money at certain rates of interest. Potential clients of the bank had to "prove" their reliability by justifying the rationality of their prospective economic plans and undertakings and had to produce some promising statements of accounts. In 1995 a committee for the monetary policy of the Central Bank was founded which passed a law on the Chinese People's Bank. Paragraph 11, for example, states that "the People's Bank establishes a Committee for Monetary Policy. The tasks, composition, and working methods of the Committee for Monetary Policy are fixed by the Council of State and are reported to the Standing Committee of the National People's Congress."[25]

The final assessment of their reliability rested with the bank directors who, as a rule, were veteran Communist Party functionaries. In their final decisions, however, the bank directors were confronted with a problem of principle arising from the contradictory purpose for which the CCP had established the credit system: if credit is supposed to create economic growth, which has hitherto been non-existent in China because the factors of production of the economy have not been able to create it adequately on their own merits, then the criteria pro or contra any decision to give credit to businessmen, enterprises and the like are still much more highly speculative than would be so in every well run Western market economy – where economic failures and bankruptcies are all part and parcel of the normal process of business. Under these circumstances, the decision to give credit is a double-edged weapon for every Chinese bank director. In his dilemma he has to follow the orders of the CCP to help to release an "economic boom" – the demand for credit being omnipresent among the newly produced economic subjects of free business. Yet, as the director of "his" business bank, he, of course, must reflect on which economic sector will bring the most lucrative rate of interest for the bank, before he decides to disburse credit. In a country like China in which credit was not (yet) helpful to the growth of the national industrial production, but in which credit substituted economic growth, this had particularly delicate consequences.

Faced with enormous inflation – which was greatly exacerbated by the state itself through the financing of its state enterprises – the economic leaders in Beijing assessed the success and at the same time the risks of their reform project. The enterprises no longer regarded money merely as a means of circulation and reckoning, but recognized that to take money was essential in a successful balancing act. Consequently, they raised their prices. In this respect, the relatively easy access to credit did indeed lead to an expansion of the business sphere, which was eventually hailed as a great

25 A German translation of the law is included in *China aktuell*, No. 6, 1995, pp. 500–503.

economic progress and success. The devaluation of the Chinese currency, the Yuan or Renminbi, conversely, showed that the enterprises had in fact increased their income in terms of sums of money, but at the same time had not (yet) increased material wealth in society to the same extent. The economic compulsion to provide the market with commodities in order to use its purchasing power was nullified by the continuous credit expansion. This means that credit did not serve its intended purpose, i.e. to function as a means of growth for national production, but substituted economic growth. And this kind of substitution of wealth was in fact of a very principal nature: credit speculation had not developed on the basis of existing business activities and helped to improve and expand them; the opposite was true, credit was only the starting-point and basis of business. Such a situation not only jeopardizes real economic growth, it also undermines the reliability of the national currency, the "epitome" of wealth and the instrument of state financial strength. Eventually, in the sphere of real estate, the devaluation of money became itself a source of profit: with the help of credit, high-rise office buildings and the like were constructed which could only become profitable business transactions if the prices for real estate continued to rise as before.[26]

With the creation of the credit sphere the CCP had established a new kind of economic standpoint and given it the power to increase money, a standpoint which eventually defended its own projects and its wealth against the centrally ordered limitations of credit, because that would have been identical to the ruin of its projects. Worried about the stability of such speculation, the CCP was not simply confronted with inconsistent relationships between the Central Bank and the various business banks, but with a very powerful interest against which it had to assert its control of the credit and speculation sphere. In order to enforce the desired use of credit raising, the CCP resorted to legal prohibitions. It declared illegal precisely the same techniques of financing which it had praised as growth-promoting in the past. In this emergency situation, the CCP resorted once more to old measures of controlling and planing which it had just abandoned. The same party functionaries who had been vested with the competencies and authority to give credit were, following the same logic, eventually reproached for "illegal enrichment" and corruption, and laws were passed against corruption and unfair competition. As a consequence, the CCP considered the credit expansion – originally initiated and promoted by it in order to create eco-

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[26] For the boom in the sector of real estate see, for example, *Renmin ribao*, 27.04.93. *Xinhua News Agency*, 10.04.93. The fact that the increase of money is not identical to the increase of real wealth also caused sceptical responses, questioning whether the impressive figures of economic growth were merely forged.

nomic growth – to be a threat to the productive growth of the national economy. This is the reason why the CCP saw itself constrained to limit the credit expansion and introduced various macro- and micro-economic mechanisms to achieve that goal. After a conference on the "disciplinary and administrative control of bank institutions" in March 1993, numerous respective legal regulations were published.[27] The volume of credits and of money in circulation was restricted.[28] In this climate the giving of credits to state enterprises was also controlled more strictly.[29] Because of the expansion of credit, the amount of investments had increased tremendously; the money supply was also said to have increased because of the growth of foreign exchange supplies of the Central Bank and because of financial expenditure. In this situation, the CCP also decided to reduce the number of futures markets.[30] Numerous laws concerning the macro- and micro-economic control and administration of the financial sector had to be introduced over the years.

In their decision to limit the giving of credit, to determine to whom to give credit, and to pay attention to the stability of its currency, the CCP had to tread cautiously. The state enterprises were still dependent on credit, and the numerous private enterprises, companies etc. would also have been bankrupted, had they been obliged to prove their actual profitability. After all, the entire economic growth was founded on the basis of credit. In the past too rigorous restrictions and limitations on credit had already led to not a few unwelcome bankruptcies and collapses. The dilemma that the reformation of the Chinese economy was both dependent and based on credit, but that the steady expansion of the credit sphere was jeopardizing the stability of currency and credit and, thus, of economic growth itself, constituted the principal contradiction with which the CCP was confronted, and it was the reason for the permanent to-and-fro in credit limitations and giving of credit and the failure to stop the speculative distension and its consequent legal adjustments. It was a seemingly insoluble search for the right balance between the two extremes. Consequently the idea of the "soft landing" became very popular. At the end of 1997, a new conference on the reformation of the financial system was organized at which new legal adjustments were decided.[31] The new round of banking reforms passed at the beginning of 1998 can be seen as an indication of the necessity for legal adjustments in this sector.

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27 *China aktuell*, No. 3, 1993, pp. 219–220.

28 *AWJS*, 29./30.04.94. *China aktuell*, No. 6, 1993, p. 560.

29 *China aktuell*, No. 4, 1996, p. 367.

30 See for example *China aktuell*, No. 10, 1994, p. 1048.

31 *China aktuell*, No. 11, 1997, p. 1083.

Shares and Stock Market

For the "financing" of its own tasks and obligations incurred by a rapidly increasing national debt, the CCP did not intend simply to print the required bank notes and in this way inflate the national credit expansion even more dizzily. Such measures would immediately have cut its own throat in its efforts to stabilize the "value" of its money. As China did not yet have a so-called "capital market", in order to raise the necessary credit the CCP faked a correct relationship between loan capital and national debt, the indebtedness to society. The state enterprises were tentatively transformed into joint-stock companies. In this way, the CCP intended to unburden the state accounts from the costs of its state enterprises and shift them from its own shoulders to newly created proprietors of the enterprises who have been commuted to share-holders by this political step: the CCP started to collect money from its citizens compulsorily in exchange for allocated, low interest rate untradable promissory notes: "In the years after the first issue of state promissory notes, the bulk of them was allocated to state enterprises and institutions which then 'transmitted' them to their employees as a part of salaries in the form of 'forced loans'. The major characteristic of these promissory notes was the fact that they could not be traded and that they were given interest periods of five or more years at a nominal interest rate of 4%. The aspects of the forced purchase and the inalienability of the promissory notes before the settlement date made them very unpopular especially as a capital investment."[32]

Indubitably a very rigorous way of raising credit from society! The CCP has practically paid its wage-earners with shares instead of regular wages in the form of money and, by so doing, tried to overcome the situation that, first, financial capital, which used the demand for money and debts to make its own profit, did not yet exist; and second, the fact that its national currency did not enjoy enough confidence to lure investors to commit their money long term. Such forced loans have but one decisive shortcoming: they prevent those who possess money from investing it voluntarily.

After having issued this kind of forced loan for several years, the CCP changed its policy, issued new promissory notes with higher interest rates and shorter periods and legalized trade with the old loans.[33] Valued at low rates, even these promissory loans can turn out to be profitable and produce

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32 Margot Schüller, "Der Wertpapiermarkt in China: Entwicklungen, Probleme und Perspektiven", *China aktuell*, No. 3, 1992, p.166 (transl. by Angela Schottenhammer).

33 As the employees who had been compelled to accept the former loss-making loans were very eager to get rid of them, this constituted an excellent chance for owners of larger amounts of money. *China aktuell*, No. 3, 1992, p.166.

a high concentration of return, as the ordinary wage-earners, of course, wanted to get rid of their stock-shares and exchange them for "real money", whereas for the richer money-owners the investment in these shares was in fact quite profitable in comparison to other investment possibilities – after all, they represented shares of the former state enterprises. In this way, the CCP started to establish a stock market and to allow a trade in stocks, shares, and loans. This created a capital market independent of the influx of foreign capital, which the state eventually intended to use for its own purposes to finance state projects by means of state indebtedness and by placing government loans on the stock-market: in order to attract the amounts of money which had so far been accumulated into its own hands, the CCP finally offered the "savers" of the nation a chance to purchase at least parts of its state economy.[34]

Many rushed to accept this offer. Apparently, after some fifteen years of market reforms, although there were not only not enough "big" money owners, the number of "small" ones was by no means negligible. Not long after the first stock markets had been established, a real run on them had started. It is not completely without historical irony that in regular mass brawls the grandsons of Mao Zedong sought to push through their alleged right to become shareholders – which was treated as the equivalent to becoming rich.[35] Consequently, the very admission to the stock market became an object of speculation and everywhere throughout the country illegal trading centres emerged, another situation requiring legal adjustments.

Profiting from the enormous demand, the share prices climbed steadily. However, as soon as the CCP started to offer larger parts of its state enterprises for sale, the stock markets reacted very sensitively to this extension offer and were subsequently destabilized. This may serve as a proof that what could be purchased in the form of enterprise shares, had initially re-

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[34] To guarantee its economic political purpose, the bulk of the property of state enterprises was still supposed to remain in the hands of the state. The CCP was apparently well aware of the fact that otherwise the state enterprises would have been completely "transformed" or turned into speculation objects of private money investors who would assess the enterprises according to their own criteria and certainly not necessarily according to the principle of guaranteeing a nation-wide functioning production.

[35] Whereas ordinary citizens in Western market economy countries are well aware of the fact that the modest amounts of money they possess are just enough to initiate modest saving deposits, in China everyone who had saved a little bit of money believed he/she could eventually become a "capitalist". Chinese society was apparently not yet successfully divided into "ordinary citizens" and "big owners of money". At least a great many Chinese citizens regarded shares in the enterprises as the opportunity to exchange their modest amounts of rapidly depreciating money into real property, and thus escape inflation.

ceived its "value" only from a comparison of this kind of investment with the rapidly depreciating national currency and therefore constituted nothing less than a risky speculation on the future profits of state industries which were notorious for their losses.

The CCP eventually had to decide whether it should just accept such teething troubles in a newly created financial and stock market, or if it was better to stabilize unpredictable share prices for the sake of attracting new money. To remain calm in face of the chaotic stock and share prices, however, was certainly not the right course for the CCP to adopt, because the capital and stock markets had not been established simply to attract domestic money but to lure foreign money investors. Consequently, the CCP divided shares and stocks into A and B stocks, and the B stocks were reserved especially for foreign investors. This division was supposed to protect some of the stocks from demand in inferior domestic currency and to ensure that those stocks became "bringers of foreign exchange". At the same time this division was supposed to protect domestic trade from the confidence resp. the mistrust of foreign investors. However, not even the most masterly and sophisticated political measure is able to guarantee a positive speculation in shares and stocks, especially when international money investors are playing the game. In this context, the CCP recognized that it would be better to implement the privatization of shares step by step, if the depreciation of money were not to be accompanied by the devaluation of the object to be privatized, and consequently stopped the issue of new shares and stocks until the end of 1994.

In the eyes of the reformers, one of the main goals within the finance sector was and is the eventual convertibility of its national currency. They intend to create a currency which would also represent wealth beyond the borders of China on the world market and which would thus open the way for Chinese "money owners" to obtain access to foreign wealth. The national currency shall provide China with access to the world market and be able to stand comparison with the currencies of other countries, and turn this comparison into a national advantage for China. The question of whether China's currency can stand comparison with other "hard currencies" thus turns out to be the crucial point in deciding whether or not the CCP will succeed in establishing a Chinese currency which possesses international value, because the national debt on which it relies initiates enough successful business transactions, i.e. relies on a real, productive economy. Of the fact that the Chinese economy, at least in 1998, did not bear comparison with other world currencies, the CCP leaders now have practical experience through the decline in value of their national currency; this circumstance has also coloured their treatment of the financial centre of Hongkong which they inherited.

The Return of Hongkong to Chinese Sovereignty

On July 1, 1997 Hongkong was returned to Chinese sovereignty. What China consequently took possession of was an economic domain of unique character. Hongkong is not simply a big trading centre and the starting-point of commodities "made in Hongkong", but is one of the largest finance centres of the world, the world's "fifth biggest foreign exchange market with daily transactions of about 90 billions of US Dollars and the sixth biggest market for derivative finance products", in short, Hongkong is, above all, a trading centre for international credit. And it is international in two respects. In Hongkong the international world of investors comes together, and their "object of desire" is not the financial strength of a single country, but complete Southeast Asia. This is one respect. But, secondly, Hongkong also disposes of an object of speculation of its own – namely China with its economic reform programme. The intention of the CCP to reform China's economy and to make it fit for the world market – since 1978 the official party line – has contributed greatly to the growth of Hongkong's financial sector, because international investors associated this decision with a great many future business prospects which would become possible through China's new politico-economic reasons of state. China was regarded precisely as a huge potential market which still had to be made accessible.

The Importance of Hongkong as Financial Centre

With the handover in 1997, Hongkong entered a new era as a Special Administrative Region (HKSAR) of the People's Republic of China. Under the "One Country, Two Systems" concept, Hongkong is charting its own course, with the exception of foreign affairs and defence. "The HKSAR's mini-constitution – the Basic Law – guarantees [that] the capitalist system and way of life in Hong Kong will remain unchanged for 50 years. Hong Kong has been promised, and is exercising, a high degree of autonomy and continues, among other things, to manage its own economic policies and finances, issue its own currency, enjoy a low and simple tax regime, maintain its own laws and common legal system, employ its own civil service, and remain a separate customs territory."[36]

In this respect, the CCP has committed itself in legal terms to respect the constitution of Hongkong, the establishment of which reveals the politico-economic goal Great Britain was pursuing in its crown colony: guaranteeing

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36 *Hong Kong Special Administrative Region - The First Six Months: The Key Issues*, 1 January 1998, p. 2.

Hongkong in its basic function as a location of the international financial world.[37] From the stock exchange Hongkong credit flowed into the entire East and Southeast Asian area and the money surpluses which had been earned with these business transactions accumulated on its stock exchange. At the same time, it is obvious that Great Britain had not set up Hongkong as a subdivision or part of its own national economy in the traditional sense of a colony. Under British sovereignty Hongkong was virtually an extraterritorial zone of market economy business life. The capital available for investment, i.e. money which had already been globally successful on the basis of a national location, flowed into Hongkong. There, a specific national currency changed its "national dress" and was exchanged for the currency of Hongkong, Hongkong Dollars. In contrast to other national currencies, the Hongkong Dollar possessed a particular economic quality. It existed only for the purpose of attracting foreign capital. This implied a positive aspect, as the HK Dollar was thus exempt from the burden of state expenditure. It was issued without regular national state intervention comprising various national claims and calculations such as the increase of national debt etc., which imply that the quality of the national currency which is sanctioned and guaranteed by law internally, outwardly still has to prove its quality as an efficacious means of doing business in global terms. Instead, the Hongkong Dollar was not affected by the increase of Britain's national debt.

The issue of banknotes was and is organized by the three great Hongkong banks, since 1993 in consultation with the Bank of China, which form a so-called Hongkong Monetary Authority (HKMA). Since the monetary crisis in the course of the negotiations for the return of Hongkong in the 1980s, the HK Dollar has been tied to the US Dollar at a fixed exchange rate. The volume of banknotes issued was orientated towards the foreign exchange reserves of Hongkong in US Dollars, i.e. it was tied to the degree business activity was already flourishing in Hongkong, to the extent Hongkong had already functioned as a successful financial centre. Thus, the quality of the HK Dollar was achieved through the financial centre of Hongkong itself, by functioning as a purely financial means for private investors who had already been successful internationally and who now looked for new sources of investments.

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[37] From the start Great Britain had established Hongkong as a trading centre – which corresponded to its original interest as a world trade power – not as a "regular colony", in order to exclude other nations from the use of this territory.

Hongkong's New Status after the Handover

The People's Republic of China has made use of Hongkong ever since. During the time of Mao Zedong, China had used this "imperialistic outpost" as its gate to the world market, serving its trading activities with market economies discretely from its inner, socialist economy. Since the beginning of the opening of China and the establishment of the SEZs, Hongkong has taken over the role of a "capitalistic motor of development". With the handing back of Hongkong to Chinese sovereignty, the particularity of Hongkong as a financial centre has in principle been rendered invalid. This is because the guarantee of using the HK Dollar to make profit in and with China, but at the same time saving the profits earned independently and outside of the political and legal access of the CCP in the extraterritorial financial centre of Hongkong – and in this way saving the profits in a currency the stability of which is not touched by a national debt policy of socialist China – has been made obsolete. Equally, the HK Dollar now is Chinese money. With the return of Hongkong, the People's Republic of China is now, by law, the sovereign of the masses of money which have been accumulated in Hongkong, but which, at least in the opinion of their owners, it does not deserve. Uncertainty about Hongkong as the financial trading centre has been the inevitable consequence.[38]

Whatever the legal niceties, both Great Britain and China were interested in maintaining Hongkong as an efficient financial centre – Great Britain, because great quantities of credit from Western countries had accumulated in Hongkong. In the contract with Britain about the return of Hongkong, the CCP had in fact insisted on being vested with the complete sovereignty over Hongkong. But it accepted the status of Hongkong as a "special administrative territory" with all the institutions and rules introduced by the British.[39] Several important court cases since the establishment of the HKSAR "have

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38 This uncertainty expressed itself, as a rule, in the fear of capital investors that the CCP could seize the wealth of Hongkong and use the local stock exchange in a way in which it was not intended to be used for its political undertakings; it was feared that instead of the officially propagated political promotion, the notorious Chinese corruption could take root and the CCP could exert pressure on the local banks to print HK Dollars for the purchase of Chinese state promissory notes.

39 'The handover was followed in September by the Annual Meetings of the World Bank and International Monetary Fund (IMF) ... They (Finance Ministers, Bankers, and some 2,000 media) also heard China's leaders, including Premier Li Peng and Vice-Premier Zhu Rongji, reaffirm the Chinese Government's determination to leave the running of Hong Kong to Hong Kong people. Hong Kong's status as a leading international financial centre was further enhanced with the naming of the Hong Kong Monetary Authority (HKMA) Chief Executive, Mr Joseph Yam, as the "Central Banker of the Year" by the magazine, Euromoney.' *Hong Kong Special Administrative Region* ... (1998), pp. 2–3.

highlighted the continued smooth running of the legal systems, as well as public confidence in the judiciary."[40] But the crucial point is the takeover itself. It is evident that the financial centre of Hongkong has now become the financial centre of China. At the same time, it is true that the CCP attaches great importance to the continued functioning of this financial centre according to its own rules and standards. Hongkong is supposed to continue to do business according to the rules of a private increase of money, measured and calculated in HK Dollars. Through this acknowledgement the CCP virtually expresses its intention to use Hongkong's financial importance and its stock exchange as the economic motor for its own development. (It should perhaps be noted that the CCP's idea and policy correspond closely to the rules of market economy).

Now Chinese enterprises no longer simply go onto the Hongkong stock exchange, rather, Hongkong has become the place where the CCP organizes its interest in the economic development of China as a particularly lucrative offer.[41] In basic sectors of the national economy, for example telecommunications, the CCP increasingly plans to use international companies to help develop China. Conversely, when the state enterprises, newly transformed into joint stock companies, are listed on the Hongkong stock exchange, they are also subject to the market criteria and calculations of the speculators. Their reaction informs the CCP about the assessment of its state enterprises in a strict economic sense. To the extent the investors on the stock exchange buy the stocks of China's state enterprises, they signal and reflect the level of interest in capitalizing its economy, which the CCP has sought to establish as a promising offer for the financial capital seeking further investment.

In accepting the legal independence of Hongkong as the financial trading centre with the requisite market criteria, implying the acceptance of the same for the assessment of the development of its own economy in terms of capitalization of the nation (and thereby also the respective assessment of its partly ailing state enterprises), the CCP betrays how it plans to use the financial centre of Hongkong. In submitting its economy to the laws and

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40 *Hong Kong Special Administrative Region ...* (1998), pp. 16–17.

41 The Chinese government provides selected state enterprises with the financial means necessary to gain a foothold in Hongkong and gives them the possibility of becoming interesting objects in themselves for investments by the financial world. This may appear to mask only an increase in the hitherto existing relations between Chinese enterprises and the Hongkong stock exchange. But in reality, in trying to make them an interesting object of investment for the financial world of Hongkong, the Chinese government, as the financial provisioner of its enterprises, intervenes in the stock exchange practically as a political monopolist. Even though the CCP follows the rules of the stock exchange, it retains particular privileges when acting as creditor and borrower in the form of its national banks and companies.

rules of the free financial market of Hongkong, the latter is supposed to function as the important balance of account – as a capital and stock market where the surplus money of investors is to be accumulated, to which profits from successful business transactions with China are transferred, from where investments throughout the entire region are to be made, and from where, eventually, the Chinese economy as a whole is to be made accessible. The growth of the financial centre Hongkong is supposed to function as a main part of the Chinese budget and balance of accounts. In other words, the investments which find their expression in the growth of the financial centre Hongkong are supposed to result in an internationally accepted value measured in HK Dollars, representing the successful national efforts of China to capitalize its economy – and with this representing China's creditworthiness. Under the sovereignty of the CCP the continuing growth of success of the financial centre of Hongkong also represents international confidence in future business prospects in and with China – and this is precisely what is intended by the CCP.

The "One Nation, Two Currencies System"[42]

As the goal of the CCP leadership is to have a currency with international creditworthiness at its disposal, it decided to make a monetary-political split and to install two currencies – the HK Dollar and the Yuan – both of which would fulfil their useful function within resp. outside China. The prerequisite for Hongkong to be able to assume its assigned role as China's financial centre was its particular status as a quasi-extraterritorial zone under British sovereignty – in other words, the sole reason for Hongkong's previous existence was to attract foreign capital. This specific status has become obsolete with the handover of Hongkong, as Hongkong is now the financial centre of China – in political terms still a socialist country; and in economic terms it has also not (yet) developed into a successful market economy. But, as we have seen above, the CCP has clearly pronounced its political intention to maintain and to continue to use Hongkong as a capitalist financial centre. Besides political and legal demonstrations which are thought to prove its political purpose and intention, and, thus, its authentic creditworthiness, in economic terms the CCP pursued this monetary-political split. In this respect, what is valid for a currency in any developed market

42 The data for the following statements and explanations were taken from monthly magazines and daily newspapers such as the *Heng Seng Economic Monthly*, the *RMRB*, or the *Frankfurter Allgemeine Zeitung*, and, above all, from the information provided monthly by the Hong Kong Economic and Trade Office, Avenue de Tervuren 188 A, 1150 Brussels, Belgium.

economy in two aspects, internal and external, is different in the China of today.

1. Internally, i.e. inside the country, China has a uniform national currency – the Yuan – which is issued by the state. The Yuan meanwhile is supposed to boost future business transactions as the only valid legal tender; in other words, China has one currency which assumes the role of a national credit money, as the general and binding measurement of the national wealth serving the purpose of finding its expression in an increase of wealth in the form of this money. The validity of the Yuan is restricted to its sovereign territory; beyond its national borders the Yuan is not traded in business transactions. Conversely, it is supposed to be the "Chinese currency", which is also used for the national debt. In other words, the Yuan is supposed to take over the role of China's state credit, for the moment still as if it were not subjected to an international comparison of its usefulness as a means of business, as the CCP has declared that it is not (yet) a freely tradable currency. 2. Externally, China does not (yet) use its national currency as a currency which is objectively assessed by the financial markets according to their criteria within the international competition of national credits because that would entail a judgement of the value of this national currency and, thus, would be tantamount to an estimate of the currency's future prospects – a judgement which the CCP believes would not yet be particularly positive. For, depending on how positive or negative this judgement turns out to be, the financial markets practically attest thereby just how useful a national currency is for doing international business and to what extent this nation really does have a "currency authority" to be used as an international financial means of business – and it is no secret that most of the countries in the world do not dispose of such a "currency authority".

Outside China, the HK Dollar is destined to be used for international business transactions. It is equipped with special guarantees to fulfil its function as an internationally valid, stable currency in Hongkong and from there transfer its positive effects into the internal Chinese economy as well. The HK Dollar is supposed to function as a reliable and stable international means of business, untouched by internal Chinese monetary affairs – foreign investments should flow into the HK Dollar, to be assessed as a separate national treasury and should in this way provide China with reliable, international credit. At least, this is the idea of the CCP. Consequently, these two sides of one national currency, implemented by the CCP for the development of China, diverge into two separate currencies. But indubitably the split in its national currency is not without consequences.

The Chinese government intends to calculate and measure its national debt in Yuan and seeks to use it as a vehicle for business transactions in "inner" China, employing it as a means to supply credit to its banks, which are controlled according to economic management and the control mechanisms imposed by a central bank. The giving of credit should run according to market criteria, but on government orders.[43] This "purely" Chinese money (Yuan) is, however, also supposed to mobilize internal Chinese business transactions and investments coming from foreign investors, who are forced to exchange their currency into Yuan if they wish to do business in China, without the "intermediary role" of Hongkong. Conversely, through the acknowledgement of the legal requirements and special guarantees under which the HK Dollar is issued and, if necessary, backed through Beijing's foreign exchange stocks, the CCP leadership accepts that this "external currency" is supposed to function purely according to the stipulations of the international financial markets in search of interesting investments, in fact especially from Hongkong to China and other regions in East and Southeast Asia. The CCP has decided to guarantee the stability of the HK Dollar as a currency which continues to enjoy international acceptance and confidence, unmolested by the internal Chinese monetary system. Through this manoeuvre, the CCP creates the fiction that it takes care of a national (Chinese) currency which it does not issue under its own sovereignty in its own politico-economic interests, but which is issued in HK Dollars purely for the interest of foreign investors to be used for the increase of their capital. This part (the HK Dollar) of the national Chinese monetary system is thus reserved for the purpose of "guaranteeing" that foreign capital continues to flow into and be invested in the HK Dollar – in acknowledgement of its liberty and mobility, and as a means by which to store profit and returns in the form of a foreign exchange stock of Hongkong banks. Therefore, in politico-monetary terms, the care taken of the HK Dollar under Chinese sovereignty, constitutes in fact a novelty in the history of political economy: a state which has decided to transform its economy into a market economy uses its sovereignty in terms of monetary authority to guarantee a currency for the purpose of private credit accumulation, issued and taken care of under its own sovereignty, but at the same time independent of its particular national interests in disposing of this hitherto fairly successful currency. To put it in another way, favouring the continued use of the HK Dollar as a successful international currency for foreign investments and business transactions with China, China is willing to renounce using the HK Dollar as a national currency, i.e. as a currency to be used for the further development of its own, not yet very successful economy. As the CCP hopes to raise international credit from the Hongkong financial world, it denies itself

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43 It should be noted that the programme of reconstructing the national economy under strict government control is not a new idea in the world of market economy. It was, for example, the key to Japan's economic success after the 2nd World War.

the opportunity of utilizing the sovereignty which it now possesses, after the handover of Hongkong, of an unlimited use and expenditure of the HK Dollar. This was done for the purpose of attracting foreign capital and maintaining the HK Dollar as a creditworthy currency and, thus, in the long run to procure for its internal currency, the Yuan, the same world-wide creditworthiness. The HK Dollar is furthermore directly linked to the US Dollar at an official parity of 7.8 HK Dollar per US Dollar – an exchange rate introduced in October 1983. The political promise to convert every HK Dollar into US Dollars provides a not unimportant security for anyone investing capital in Hongkong. In 1997 the CCP was able to continue this linked exchange rate system on the basis of and because of Hongkong's economic success prior to its return to mainland China.

Problems of Guaranteeing the Stability of the Hongkong Dollar

With the described division of the monetary system under Chinese sovereignty, the CCP leadership has provided the financial world assembled in Hongkong with a good many reasons for making a reassessment of the Chinese financial forum, Hongkong. Hongkong is now supposed to be used primarily for the future development of China, but conversely it is to be completely "reserved" for the financial interests of the financial world. Confronted with the new political status of Hongkong as a part of China, international investors have inevitably subjected Hongkong to an international comparison. First, they speculated on a further boom in successful business relations with China, as in their eyes the new status of Hongkong could only improve the possibilities for profitable business with China. Thus, Chinese stocks experienced a certain boom. At the same time, bowing to the influence of the economic crisis in Asia, the speculators have raised the question if and to what extent the financial centre Hongkong is good enough to be used as an exceptional case of a regional "crisis insurance". As an investment centre for the whole region, Hongkong is, of course, affected by the Asian crisis. Consequently, its suitability for guaranteeing better access to the Chinese market has become a topic of discussion. Against the background of the crisis, many investors have reassessed their confidence in the "huge Chinese market", so this test turned out disappointingly, and in Hongkong exchange rates and stock prices fell. As the rates went down in response to speculation, the question arose whether China would and could in fact be able to guarantee the stability of the HK Dollar with its own economic success, intending at the same time to use the credibility of the HK Dollar for its future economic success. This question arose because the HK Dollar was and is no longer regarded as a separate, reliable means of business, but as a special Chinese currency and, consequently, the credibility of China as the "guardian" of this money is being called into question.

China has to stand the speculative comparison of the financial world and to show to what extent it is able to maintain the stability of the HK Dollar. The determination to maintain the exchange rate between HK Dollar and Yuan in relation to the US Dollar is a professed intention by the political leadership of the CCP to ensure that the means of Chinese creditworthiness is not eroded. But in terms of financial policy the divided national currency constitutes the permanent test of how far the CCP is willing to go to secure international creditworthiness and have its national business success in the form of foreign exchange be used to back the HK Dollar as a means of international credit. The CCP leadership has repeatedly expressed its intention of maintaining the exchange rates, i.e. to guarantee the stability of the HK Dollar with the help of its foreign exchange stocks. But the idea of the CCP of keeping an "internal currency" stands in contradiction to an albeit equally state-guaranteed "foreign exchange currency", which will be mobilized as a means of credit for the development of China. This can only be successful to the extent to which this currency (HK Dollar) is backed by the Chinese government, as it becomes the object of speculation on and of the "markets", which simply test the "durability" of the HK Dollar.[44]

At the same time, China and its financial centre Hongkong are subject to a particular political risk which foreign investors have to take into consideration: the CCP is confronted with the problem that foreign "strategic" and political scruples about China must remain subordinate to the economic interest of the financial world in China – in other words, that despite of various political risks, the business world continues to invest in China and Hongkong.

The CCP leadership in Beijing has announced to the general public that it is willing to stand this test. Both national currencies are to be standardized in terms of value, in the sense that in about fifty years[45] China's internal economic "means of state credit", the Yuan, will have developed into a currency internationally in demand on the world market with the help of the proper use of the HK Dollar as an already established, international creditworthy currency. The CCP hopes that by then its national currency, the Yuan, will be in such demand that with and in the Yuan the Chinese market will have proved to be what has so far only been the fantasy of the CCP:

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44 The way in which this is reflected in the ups and downs of the rates at the Hongkong stock exchange will not be examined here. But the credit crisis in the Southeast Asian "tiger states" has had effects on China, as the HK Dollar, which had extensively been invested in those regions, is affected in its creditworthiness as an international useful currency.

45 According to the contract with Great Britain.

free of the necessity first to have to attract foreign credit and capital under special conditions, but able to participate and make use of the global economic growth and credit speculation by means of its own stability and creditworthiness, without the intermediary role of the HK Dollar but on the basis of a growth of China's own economy.

Conclusions

At the moment, if foreign capital is going to invest in China, the Chinese government – besides providing the foreigners with cheap workers and tax benefits or exemptions – via fixed exchange rates always has to guarantee that the foreigners at any time will be able to change their profits made in China and in Chinese currency into US Dollars, into a strong and stable universal money. Practically this means that foreign capital makes profits in and with China but in the end always prefers to withdraw its profits in order to convert them into "strong" currencies, because in China economic conditions which would allow a permanent profitable reinvestment of capital have not yet been established. Consequently, with the help of foreign capital, which uses China for its own accumulation, the Chinese government seeks to manage to build up a national Chinese accumulation (capitalization) which is so profitable to foreign investors that they are all interested in acquiring the measure of wealth in the form of which business activity on the Chinese markets is expressed. In this context, the CCP hopes that in the near future the Yuan will have become a stable, convertible currency – a universal money – which is in such a demand by international investors that China will be able to pay for and afford any national project she wants, similar as for example the USA are able to do now – this is the Chinese expectation of a successful participation in the global economy.

To guarantee this new politico-economic purpose – to make the Chinese Yuan a stable currency in international demand (to be used for the growth of the Chinese economy and for the state projects of the CCP) – with all its legal consequences for the state, the citizens in general, for workers, businessmen, private investors, bankers, private owners of property etc. it goes without saying that many new laws and legal regulations have had to and will still have to be established, as well as old ones reformed. As a step to the adjustment of the credit and banking system to market practices and the establishment of a respective bank legislation, the CCP had, in January 1998, proclaimed new regulations, for example that the "People's Bank of China (PBC) will draw on international management practices for administrative reforms to increase independence, authority, and professionalism of the central bank. This will entail the gradual closure of provincial PBC branches and a number of regional branches will be set up ... Capital markets with risk funds and industrial funds will be developed so that individual capital can be directed to enterprises with a good record and banks will raise funds indirectly ..."[46] But what immediately springs to mind is that a legal regulation of the credit system can, of course, not be the guarantor of the respective economic success, because the speculation on making profit in China does in fact require a legally sanctioned banking system with the concomitant market regulations as an essential condition, but it can never guarantee the real economic success. This was made painfully evident as Hongkong was more and more affected by the financial crisis in Asia this year. But, at least this time, China achieved her goal.

To summarize, the reform programme which the CCP seeks to realize in and with China, is in fact an ambiguous one fraught with many problems, but so far it has indeed been successful and the prospects are by no means hopeless. To a certain extent China has actually already become a new "Middle Kingdom". Whether, however, the CCP's ultimate purpose becomes reality or not will depend on the (future) development of global business prospects and, last not least, on the extent to which the leading economic countries, especially the USA, are willing to "accept" China's success in world-wide competition.

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[46] Xinhua News Agency, 21.01.98.