

## THE CHINA SYNDROME: A TRAP FOR UNWARY INVESTORS

INVESTORS are being encouraged to direct funds to the "emerging" markets on the assumption that the world in the 21st century will be roughly as it is today. In fact, geo-political pressures are building up which offer scope for drastic adjustments, with attendant heavy losses.

The level of control over events in these countries is far weaker than we are led to believe. The crude inter-governmental consensus which now prevails, in the absence of the bilateral East-West/Capitalist-Communist nexus, is disguising pressures that are threatening a major breakdown of social order on a regional basis in the Far East, Africa and Latin America.

EI anticipates that the crises in these regions will be triggered by the demands exacted on them by governments in North America and Europe, as a result of domestic pressures. The world, in other words, is in a period of calm before the storm.

The power of blue-collar workers has been neutralised by the crushing of their trades unions, but the next decade will see the flexing of power by white-collar workers who now realise that the threat of redundancy and forced early retirement is not receding. These groups will mobilise themselves into new institutions that will be able to compel governments to take "strong action" in their interests. And that is when the richer nations will begin to impose themselves on the weaker economies, creating a domino-style stream of conflicts that would exact a heavy price on investors who have backed the losers.

THIS IS not to say that investors should steer clear of the "developing" countries. The problem is to decide which are likely to be the most stable regions.

At present, what looks like safe-bet economies are at risk of erupting because of external pressures. Investors need to identify those countries that are likely to be the most resilient in times of disturbing change in the first decade of the next century.

For statesmen who want to secure the living standards of their countries in the upswing of the new cycle, the only safe outlook is to presume that we are all back to square one: relearning the knack of creating and selling wealth. For practical purposes, no nation should presume that it is protected by the advantages it enjoyed in the past.

The global depression has reduced

every country to a state of either heavy unemployment, or a state of heavy dependency (for markets) on countries with heavy unemployment. Taiwan is only secure for so long as its customers in Europe can buy their exports. This means that every country in the world is now equally vulnerable to trends that have converged on a single business cycle.

Supplementing the risks of the global depression are the opportunities created by the retreat from communism, which has opened up new markets: the late 20th century's equivalent of the 19th century Scramble for Africa. To protect market shares, today's corporations will have to invest in a new approach to marketing if they do not wish to be mauled by the new predators that are even now plotting their future growth.

In short, every country in the world is now in the category of a developing economy. Which is why the Chinese experiment is pregnant with lessons for every policy-maker who is interested in restructuring his economy.

MORE ATTENTION is being paid to news about Russia than to what is going on in the Orient. This is a bad mistake. Even so, Russia bears close scrutiny, if only because western investors are now beginning to flirt with the idea of sinking a lot of capital through Moscow and St. Petersburg.

Russia has become a victim of conventional economic wisdom. She turned to the West for advice, and has paid a terrible price. Market economists prepared "shock therapy" plans for Moscow without taking into account the lessons that they could have derived from what has happened in China. As a result, Russia's reformers have lost the initiative, and the dinosaurs from the industrial/military complex exercise considerable power in the Kremlin.

Whether Russia will suffer a Weimar-style collapse - as popular political and Press wisdom in the West now suggests - remains to be seen. But there is no doubt that Russia's reformers had been sold a carbon copy of the Western market model, failures and all.

The political situation in Russia is

an exceedingly fragile one. The World Bank's influence in Moscow will last for as long as Boris Yeltsin can hang onto the Kremlin. His political position is now being called into question in Russia, and he does not have the power base that could withstand the kind of challenge which confronted him in October last year, when he sent the tanks to knock-out Parliament.

As it happens, the demise of western influence over the reform programme in Russia, in EI's view, would turn out to be a blessing for the Russian people. Whether they then construct a more comprehensive strategy for socio-economic renewal would depend on whether they learnt the appropriate lessons. Their first port of call ought to be China.

IN 1978, the Chinese communist party instituted what appears to be a relatively orderly shift to market economics. Surely that experience provides lessons that could be used to engineer an even smoother transformation in Russia?

Industrial output in China has out-classed the performance of the market economies by a huge margin. The annual rate of growth of income is in the 12-13% sphere. The Chinese seem to have discovered a secret for which the Russians, alone, would be willing to pay a handsome price!

In fact, there is no secret. The Chinese have simply unleashed the creative energies of their citizens, freeing their labour and allowing them to produce for private profit. A large part of China's performance is due to the take-off from a low base. The rate of growth, unsustainable in the long run, could continue for several decades. The growth rates are not exceptional for the performance record of Asian economies; and China has yet to tap the rich opportunities of its hinterland (the capitalist economy is largely restricted to the coast).

But there is a catch with the Chinese model which has nothing to do with Peking's propaganda about combining socialism with capitalism.

The land market is not working properly, either for the private or public sectors. It is in this area that analysts

ought to be directing their attention, if they wish to develop strategies that would ensure sustainable growth.

Deng's theoreticians failed to develop a strategy for the use of land when they decided to "free" the market in 1978. Result? Speculation in the rent of land was back on the agenda in China. From that date on, it was possible to anticipate a land boom in 1993 which would terminate in 1994, before sliding into a generalised crash in 1996. That sequence is now unfolding itself.

The Peking government panicked in July last year, and tried to curb "property speculation" by ordering banks to cut credit to speculators. Too late: the rot had set in. The current boom conditions can be traced to the illusions created by speculative fever of the kind that gripped the market economies in the late 1980s.

The foreign investors who are now pouring funds into China will get burnt within the next few years.

IT NEED NOT have happened. Had the Chinese economists retraced their steps, and studied the works of Sun Yat-sen - who had learnt his economics from John Stuart Mill and Henry George - they would have stared the truth in the face. Instead, they tried to relearn the principles of market economics from the texts of Karl Marx.

That was not necessarily a bad move. Marx, in Vol.3 of *Capital*, did lay bare the elements of economic theory that would have made it possible to rebase the Chinese economy on sound principles. But Marx was not interested in developing his ideas in the direction of a reformed system of capitalism. So he did not undertake the work that would have provided a clear picture of the appropriate distribution of income between the private and public sectors - a distribution which (as his contemporary, Henry George, was to note) would have elimi-

nated speculation in the land market, thereby removing the single most destabilising factor in the markets.

For Marx, both the profits of capital and the rent of land were "surplus" income. Deng's associates have found it difficult to shake-off the blurred images conjured up by that confusion, so they are not differentiating between the public and the private value being generated by their new capitalist sectors. What they are doing is fostering the beast in the breast that has already reared its ugly head. Smiting it - by using conventional western market techniques - will leave many people jobless in China, and the ensuing chaos will have geo-political implications.

THE CONFUSION is reflected in the analysis by Zhang Chunyin and Kong Min, who wrote "The Price of Land and the Payment of Fees for Land Use in Socialist Economy" in 1984.\*

They provide a valuable historical insight into prices before the communist take-over, when the market determined the price of land. In Tianjin city, for example, appraised prices (for tax purposes) ranged from 500 yuan per mu (15 mu = 1 hectare) to 20,000 yuan per mu, a difference of 40 times. (Market prices could be three times greater than appraised prices!)

After 1952, free market land deals were banned. Land was still priced for tax purposes, but the price was calculated according to bureaucratic formula (which is the basis on which some Russian civil servants think they can now create a land "market").

Today, the Peking mandarins have failed to develop land rights to make them consonant with the needs of both a free market and a stable social system.

Marx himself had no doubts about the unique nature of land. In Vol.3, he explained:

"Looking from the angle of a higher

social economic pattern, private ownership of land by an individual, like the ownership of one person by another person, is preposterous. Even the whole society, a nation, and all the existing societies put together are not owners of the land. They are merely the occupants and users of the land and, like a good patriarch, must improve the land before handing it down to posterity."

Margaret Thatcher reiterated this philosophy, when she declared before the end of her tenure as premier of Britain: "No generation has a freehold on this earth. All we have is a life tenancy with a full repairing lease".

The Chinese communists, however, had problems in applying the philosophy in practice. They have leased - not sold - the land; but they have failed to put in place the laws and institutions to socialise the rent of land. Had they done so, they would have eliminated the need to tax wages and profits, which would have placed the new Chinese economy on a sustainable foundation.

We fear, in fact, that the temptations of the land market will be too great for Peking to resist. The Chinese leaders are already locked into the desire to exploit land for short-term gain, and the richest pickings of all will come when they regain control over Hong Kong.

\* Mainland Chinese interests already own about US\$10bn of residential and commercial property in the British colony.

\* When the Chinese take control in 1997, they may try to fund the mainland budget by exploiting property in the former colony. For example, British Army land alone has a commercial development value of over £50bn.

WHETHER the Chinese treat the island as a rich milch cow will depend on whether Peking quickly learns the lessons of the land market.

As things stand right now, we fear the worst. Hong Kong could become even richer, if the disruptive power of land speculation is eliminated on the basis of market principles (see page 4). The most likely scenario is that the Chinese will put old ideology before new economics. That will unleash instability that will send shock waves right through the Pacific Rim, the impact of which will be felt in the world's consumer as well as financial markets.

\* Reprinted in Lester Ross and Mitchell A. Silk, *Environmental Law and Policy in the People's Republic of China*, New York: Quorum Books, 1987.

