China: Glass-Steagall Banking System and the Belt and Road Initiative

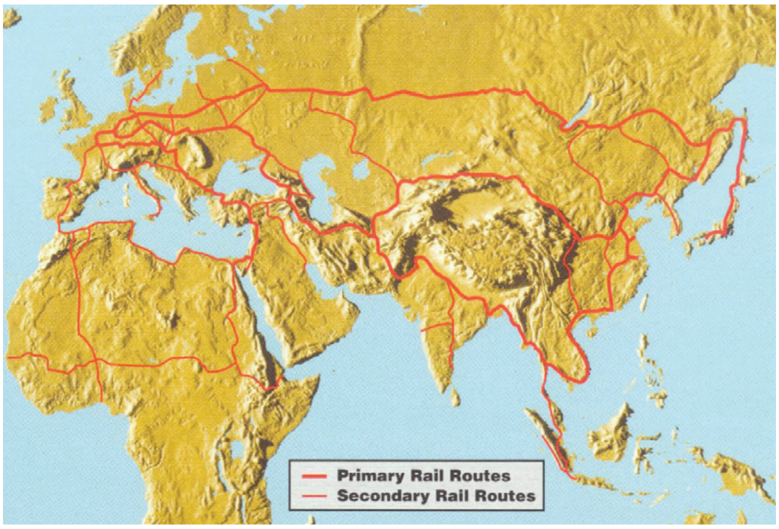
The germ of a new, just world economic order already exists. Its leading edge is China's Belt and Road Initiative (BRI), unveiled by President Xi Jinping in his announcements of, first, the Silk Road Economic Belt during a September 2013 speech in Kazakhstan and then, the next month in Indonesia, the Maritime Silk Road. China is promoting the BRI infrastructure cooperation in bilateral agreements, as well as through the Shanghai Cooperation Organisation (SCO) and BRICS (Brazil, Russia, India, China, South Africa). Xi and President Vladimir Putin of Russia have launched coordination between the BRI and the Eurasian Economic Union (Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia).

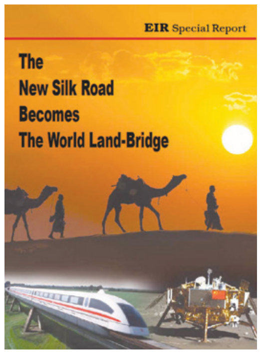
Few people realise that the success of China's extraordinary growth plans has relied on the implementation of credit and banking policies, which incorporate the Glass-Steagall principle of banking separation to protect productive lending from speculative.

Twenty years ago, these Eurasian continental development schemes were only an idea. The pictures below illustrate the Eurasian Land-Bridge idea in initiatives by China, as well as publications of the CEC and EIR Special Reports, because the international LaRouche movement has been involved with bringing it to life since 1992. Indeed, ideas have the power to change history!

At the September 2016 Group of 20 summit in Hangzhou, Xi situated the BRI in China's achievement of the past three decades: 700 million people have been lifted out of poverty, in a stunning "endeavour never undertaken in the history of mankind". Now, he said, clearly aware of the looming next global crash, "we can no longer rely on fiscal and monetary policy alone". Rather, "We have to create a chain of win-win global growth" based on scientific and industrial revolutions, a "new path of economic development" worldwide, "to abolish poverty and hunger".

To finance its extraordinary growth, China implemented Glass-Steagall-modelled banking reform in 1993. It has issued credit at the rate of $4 trillion (equivalent) annually since 2009, generating demand for real products, as well as investment in infrastructure abroad,





The Schiller Institute mapped the vision of a future Eurasian Land-Bridge (top right) in 1992. In 1996 Schiller Institute founder Helga Zepp-LaRouche addressed a seminal Beijing conference on the New Euro-Asia Continental Bridge (top left). Above (l. to r.): EIR's 1997 Special Report spread the proceedings of the Beijing symposium worldwide; the 2001 CEC book *What Australia Must Do to Survive the Depression* linked our country's future to success of the Land-Bridge; Zepp-LaRouche in a Chinese TV interview, 2014; and the 2014 EIR Special Report on a World Land-Bridge.

thus propping up the entire world economy. China's steps towards a new global financial and economic architecture include:

• new institutions to finance physical-economic growth, including the Asian Infrastructure Investment Bank and the BRICS New Development Bank, the New Silk Road Fund, the Maritime Silk Road Fund, and others;

• the Belt and Road Initiative (BRI), in which over 100 countries are now participating;

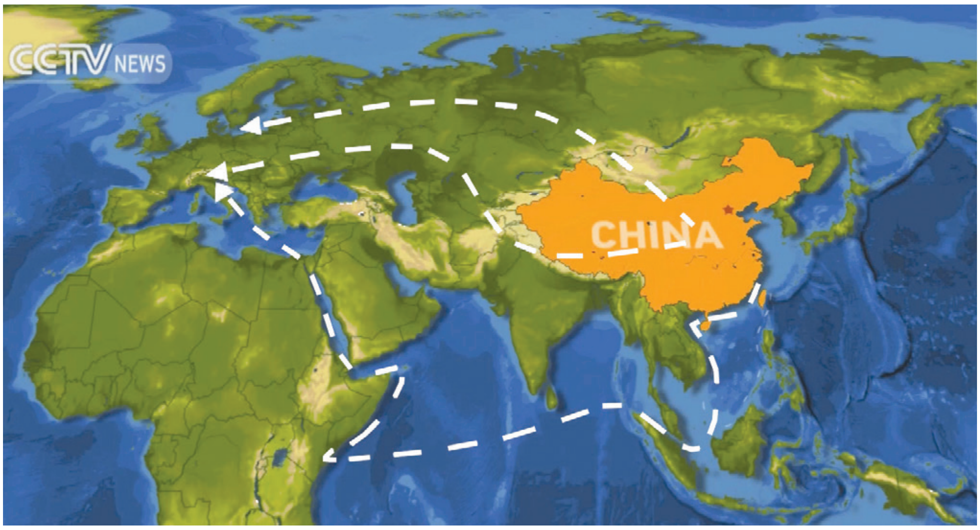
• construction of more than 20,000 km of high-speed rail in the last decade, building a network that will reach 45,000 km by 2030, connecting all major cities in China; hundreds of new cities to house the hundreds of millions of people exiting from rural poverty;

• the two greatest water projects in the world, the Three Gorges Dam and the South-North water diversion program;

• the initial stages of the world's largest, most advanced nuclear energy program;

• the world's most ambitious space program, coupled with research on controlled thermonuclear fusion power, which could use helium-3, mined on the Moon, to power Earth's civilisation cheaply and cleanly for 7,000 years;

• uplifting its cultural life through the largest Western Classical music program in the world, planning to raise the share of scientifically literate citizens to 10 per cent by 2020.



In 2013 Chinese President Xi Jinping announced his program for the new Silk Road Economic Belt (top two broken white lines) and the 21st Century Maritime Silk Road (lower broken line). Together the infrastructure and development projects, which include Chinese financing for projects in the cooperating countries, are called the Belt and Road Initiative (BRI). Source: Screen grab, Chinese Central TV.

Contrary to Anglo-American propaganda about a communist behemoth bent on global expansion, China is guided by the ideas of the great humanist Chinese philosopher Confucius (551-479 BC), as reflected in President Xi's constant emphasis on the BRI program's "win-win" nature, bringing mutual benefit for all nations involved.

Glass-Steagall and "American System" Principles in China's Banking System

Yi Gang, former deputy chairman of the People's Bank of China, wrote a chapter in a 2010 book on China's financial and economic policy, *Transforming the Chinese Economy*, edited by Fang Cai. In Yi's chapter, "The intrinsic logic of China's banking reform", he explains that China's banks have been governed by the Glass-Steagall principle—the separation of commercial banks from speculative finance—for nearly 25 years.

Yi writes that "at the initial stage of reform and opening"—the economic liberalisation launched in 1978—"China adopted the mixed operation ['universal banking'] model under which a commercial bank (China Communications Bank) was allowed to operate brokerage insurance business. But in the midst of economic overheating and financial chaos at the end of June 1993 … policymakers held mixed operations partly to blame and decided to draw on the U.S. experience of separating commercial banking from investment banking." Yi describes the banking and securities laws that were then passed in order to do this, and summarises: "China officially embarked on the path of separating commercial banking from investment banking, and told commercial banks to disconnect from their securities firms and investment companies."

Yi describes how the issue was debated again a decade later, with economists (himself included!) arguing in favour of "universal banking". But the trans-Atlantic financial blowout of 2007-08 settled the issue once again, in favour of the Glass-Steagall principle.

Moreover, a February 2012 Bank for International Settlements (BIS) report, "Development and Utilisation of Financial Derivatives in China", makes the point that financial derivatives transactions in China's commercial banks still represent only a small proportion of their overall business. Interest- and exchange-rate derivatives posted a volume of almost 6.8 trillion yuan in 2008 and 2009. By the end of June 2014, the total of interest-rate and exchange-rate derivatives had reached 9.7 trillion yuan, about US$1.42 trillion. Thus the derivatives market in China accounts for only 0.33 per cent of the global market, according to the BIS. Compared with China's share of global GDP, China's banking sector is very cautious in its use of derivatives. This means, of course, that Chinese banks can handle the default of bad debts and failures of delinquent companies they have loaned to, without spreading a financial crisis.

As of November 2016, China's banking system had issued, according to some estimates, $20 trillion in credit for economic expansion since 2008. Nonetheless, its exposure to derivatives remained in the low single-digit trillions of dollars nominal value, out of the $600 trillion global derivatives total estimated by the BIS.

Despite having laws that separate commercial banks from shadow banks, on the Glass-Steagall model, China in 2016 further tightened up on commercial banks' derivatives exposure. The China Banking Regulatory Commission (CBRC) is doing what the Federal Reserve was tasked to do by the original *Glass-Steagall Act*—protecting commercial banks from themselves, limiting them to loans and generally sound investments.

CBRC's new regulations, Xinhua reported 28 Nov. 2016, establish more detailed guidelines on how banks must calculate their financial exposure to counterparty risk, in both exchange-traded options and futures, and over-the-counter derivative contracts on interest rates, etc. Xinhua reported that the new rules have raised banks' capital reserve requirements for derivatives positions, and, "compared with current requirements, set clear standards on what risk factors should take precedence under which circumstances. This reduces ambiguity that has been exploited by some banks to understate the risk they actually face in the derivatives business."

Who's Got it Right—China or the Financial Experts?

Economists and financial experts, whose assumptions led to the 2007-08 financial crisis and ensuing global economic downturn, either ignore or belittle the success of how the Glass-Steagall principle has been applied in China. Instead, they insinuate that China, which since then has single-handedly kept the world economy moving enough to prevent a full-blown depression, has got it all wrong. On 24 May 2017, just ten days after the Beijing Belt and Road Forum for International Cooperation, Moody's rating agency downgraded China's financial rating for the first time since 1989. The agency warned of "economy-wide debt continuing to rise as potential growth slows". Moody's also downgraded a number of Chinese state enterprises.

The Chinese Finance Ministry responded that the Moody's downgrade "was based on an inappropriate 'pro-cyclical' rating measure" and that the agency has "overestimated the difficulties China is confronting and underestimated the government capability in deepening structural reform and appropriately expanding aggregated demand". The ministry pointed to a "lack of necessary knowledge of China's laws and regulations" when it comes to concerns for the increasing debt of local government financing vehicles and state-owned enterprises.

China not only directs the bulk of new debt into the productive economy, but its Glass-Steagall-style banking regulation also prevents banks from gambling rather than lending into the real economy. President Xi has also initiated a crackdown on real-estate speculation, along with tighter regulations against illegal financial activities, and there is a process under way to reorganise bad debts and unwind excess leverage. Government-directed credit spent on nation-building, particularly public-sector infrastructure, is a different proposition. Intended for the long term, it doesn't show results on the balance sheet immediately.

No successful economy has ever been afraid of debt. Look at the impact of China's debt, reflected in the many projects of the Belt and Road Initiative (BRI) under way across Asia, eastern Europe, the Middle East and Africa. More concrete was poured in China alone in 2011-13 than was used in the USA during the entire 20th century! Building roads, tunnels, bridges and new cities not only results in necessary new infrastructure, but, crucially, in new jobs.

Credit, if used correctly, is simply an advance made for work to transform the economy, which pays off through the development of the nation and its productive output, the transformation of the population and the workforce, and the building of infrastructure which increases the potential of every industry and business it intersects.

"Experts" like Moody's analysts challenge the sustainability of China's growth model, but in reality, as long as there's something more to be done, the economy will always have potential for growth. It is up to governments to map a future trajectory and ensure necessary projects are incentivised and taken up.

Referring to ongoing reforms in China's financial sector in a 25 May 2017 article in the *Australian*, China correspondent Rowan Callick said that the Chinese government "continues to act as if it, rather than the market, is best placed to price risk". He derided the model by which "a government orders banks it owns to lend money its central bank prints, to local governments it fully controls (in theory, at least), which in turn raise more money by selling bonds to other banks, and which then give the money to state owned enterprises, national and local, to spend on infrastructure projects".

That sounds better than the system where a government fully owned by big corporations and banks, run by politicians who started their careers in those same corporations and banks and who return to them after their political careers end, uses those corporations and banks to sell off the nation's infrastructure and utilities, many of which are acquired by those same corporations and banks which are also paid a handsome fee for conducting the sale, and reap the profits forever more. Despite all the criticism, nobody actually expects China to collapse, or even go into recession anytime soon.

The Glass-Steagall Divide

It is instructive to contrast the economic results of China's application of the Glass-Steagall principle in banking, with those of countries which have eliminated Glass-Steagall. In the early 1990s, as Glass-Steagall banking regulation was in its final spiral of decline in the western world, China was just introducing it. While the West was consumed by the unprecedented financial gain associated with a growing criminal enterprise of gambling and looting, in the East, China envisioned a long-term plan to uplift its people from poverty and develop itself and the world. Glass-Steagall regulation, which separates retail banks that provide funding for the real economy from speculative investment banks, is the indispensable condition for such a pursuit.

Following the success of Chinese leader Deng Xiaoping's "reform and opening up" agenda and the advent of a "socialist market economy", Chinese banks at first were using any means at their disposal to raise money and speculate, including the use of savings deposits. Thus, as reported by Yi Gang in the book cited above, it was necessary to legislate a firewall between commercial and investment banking activity to prevent this. In 1993 China introduced its equivalent of Glass-Steagall banking separation to dry up speculation and instead focus investment into production and development. China also began to develop its state-directed financial system, to make credit available for this purpose.

When the People's Bank of China was given authority over commercial banks, and announced in June 1993 that it would "separate commercial banks from their affiliated trust and investment firms", three policy banks were created to oversee government-directed spending and the development of the nation. China is still continually revising and strengthening its financial regulatory framework to protect the banking functions crucial to economic growth, in sharp contrast to the West.

Meanwhile, in the USA the repeal of Glass-Steagall resulted in 1999 from a long process, led by the City of London and its Wall Street bastion. The official repeal of U.S. banking separation had been preceded by similar action in Europe starting at the end of 1989; that, in turn, had been preceded by the City of London's Big Bang deregulation in 1986, aimed at creating a new global financial superstructure with London as the heart.

After the Berlin Wall fell in 1989, British Prime Minister Margaret Thatcher, working with French President François Mitterrand, moved to prevent the emergence of a strong, sovereign Germany, and to sabotage reconstruction of national economies in the East. Sovereign banking regulations were dismantled in favour of moves towards a European Banking Union. Glass-Steagall-type laws were eradicated in many European nations. On 15 December 1989, a month after the fall of the Berlin Wall, the European Commission issued Directive CE 646/89, which allowed any credit institution to engage in the entire spectrum of risky speculation, including derivatives trading. It also opened up the banking sectors of all European nations to City of London domination and control. Just prior to this directive, on 30 November 1989, Deutsche Bank chairman Alfred Herrhausen was assassinated. The most influential figure in corporate Germany, Herrhausen had been pushing for the industrial development of Germany, foreseeing "great economic possibilities" for Eastern Europe. Following Herrhausen's death, his friend German Chancellor Helmut Kohl capitulated to the demands for the destruction of national sovereignty, ushered in by immediate moves to a monetary union.

It was the City of London that had assailed sovereignty since the time of World War I, including through the movement to create a European Union, and in the post-war period had worked assiduously to subvert Bretton Woods-era financial controls, including the Glass-Steagall banking separation in effect in many countries. Prior to the Big Bang in London's financial markets, Glass-Steagall-type banking separation was the prevailing reality even for British banks. Rather than a formal rule, separation between commercial and "merchant" banks existed by convention. In an economy still mostly oriented to real economic activity, a natural divide had formed whereby commercial banks operated much as utilities do, providing a vital service for the conduct of business, and merchant banks conducted investment activity, but did not take deposits or offer basic consumer services.

Thatcher's chancellor of the Exchequer at the time of the Big Bang, Lord Nigel Lawson, told BBC radio in 2010 that London had been determined to remain the global centre of finance as the world moved to a global marketplace. The City of London, therefore, "could no longer be based ... on the capital put in by a certain number of wealthy individuals. It had to be much bigger than that—which meant having corporate capital in, and allowing overseas capital in".

This spelt the end of the traditional separation of bank activity. Lawson, who today advocates the reintroduction of Glass-Steagall, explains that bankers wanted to "get their hands on the deposits", so as to leverage them in the drive for bigger financial profits from high-risk activity. Ridding the world of FDR's Glass-Steagall protection thus set up the ever increasing divide between rich and poor, the big corporation and the individual citizen, until China took up the baton.