

Why China Is Running Circles Around America

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“One Belt, One Road,” China’s \$1 trillion infrastructure initiative, is a massive undertaking involving highways, pipelines, transmission lines, ports, power stations, fiber optics and railroads connecting China to Central Asia, Europe and Africa. According to Dan Slane, a former adviser in President Trump’s transition team, “It is the largest infrastructure project initiated by one nation in the history of the world and is designed to enable China to become the dominant economic power in the world.” In a Jan. 29 [article](#) titled “Trump’s Plan a Recipe for Failure, Former Infrastructure Advisor Says,” he added, “If we don’t get our act together very soon, we should all be brushing up on our Mandarin.”



On Feb. 12, Trump’s own infrastructure initiative was finally unveiled. Perhaps intending to trump China’s \$1 trillion megaproject, the administration has now upped the ante from \$1 trillion to \$1.5 trillion, or at least that’s how the initiative is billed. But as Donald Cohen [observes](#) in *The American Prospect*, it’s really only \$200 billion, the sole sum that is to come from federal funding. And it’s not even that after factoring in the billions in tax cuts in infrastructure-related projects. The rest of the \$1.5 trillion is to come from cities, states and private investors, and because city and state coffers are depleted, that chiefly means private investors. The focus of the administration’s plan is on public-private partnerships, which, as Slane notes, are not suitable for many of the most critical infrastructure projects, because they lack the sort of ongoing funding stream—such as a toll or fee—that would attract private investors. Public-private partnerships also drive up costs, compared with financing through municipal bonds.

In any case, as Naked Capitalism blogger Yves Smith [observes](#), private equity firms are not much interested in public assets, and to the extent that they are, they are more interested in privatizing existing infrastructure than in funding the new development that is at the heart of the president’s plan. Moreover, local officials and businessmen are now leery of privatization deals. They know that the price of quick cash is to be bled dry with user charges and profit guarantees.

The White House says its initiative is not a take-it-or-leave-it proposal, but the start of a negotiation, and that the president is “open to new sources of funding.” But no one in Congress seems to have a viable proposal. Perhaps it is time to look more closely at how China does it.

China’s Secret Funding Source

While American politicians argue endlessly about where to find the money, China has been forging full steam ahead with its megaprojects. A case in point is its 12,000 miles of high-speed rail, built in

a mere decade, as American politicians were still trying to fund much more modest rail projects. The money largely came from [loans](#) from China's state-owned banks. The country's [five largest banks](#) are majority-owned by the central government, and they lend principally to large, state-owned enterprises.

Where do the banks get the money? Basically, they print it. Not directly. Not obviously. But as the Bank of England has [acknowledged](#), banks do not merely recycle existing deposits but actually create the money they lend by writing it into their borrowers' deposit accounts. Incoming deposits are needed to balance the books, but at some point these deposits originated in the deposit accounts of other banks. Because the Chinese government owns most of the country's banks, it can aim this funding fire hose at its most pressing national needs.

China's central bank, the People's Bank of China, issues money for infrastructure in an even more direct way. It has turned to an innovative form of quantitative easing, in which liquidity is directed not at propping up the biggest banks but at surgical strikes into the most productive sectors of the economy. Citigroup chief economist Willem Buiter calls this "qualitative easing" to distinguish it from the quantitative easing engaged in by Western central banks. According to a 2014 Wall Street Journal [article](#):

In China's context, such so-called qualitative easing happens when the People's Bank of China adds riskier assets to its balance sheet—such as by relending to the agriculture sector and small businesses and offering cheap loans for low-return infrastructure projects—while maintaining a normal pace of balance-sheet expansion [loan creation]. ...

The purpose of China's qualitative easing is to provide affordable financing to select sectors, and it reflects Beijing's intention to dictate interest rates for some sectors, Citigroup's economists said. They added that while such a policy would also put inflationary pressure on the economy, the impact is less pronounced than the U.S.-style quantitative easing.

Among the targets of these surgical strikes with central bank financing is the One Belt, One Road initiative. According to a 2015 Bloomberg [article](#):

Instead of turning the liquidity sprinkler on full-throttle for the whole garden, the PBOC is aiming its hose at specific parts. The latest innovations include plans to bolster the market for local government bonds and the recapitalisation of policy banks so they can boost lending to government-favoured projects. ...

Policymakers have sought to bolster credit for small and medium-sized enterprises, and borrowers supporting the goals of the communist leadership, such as the One Belt, One Road initiative developing infrastructure along China's old Silk Road trade routes.

'Nonperforming Loans' or 'Helicopter Money'?

Critics say China has a dangerously high debt-to-gross domestic product ratio and a "bad debt" problem, meaning its banks have too many "nonperforming" loans. But according to financial research strategist Chen Zhao in a Harvard University [study titled](#) "China: A Bullish Case," these factors are being misinterpreted and need not be cause for alarm. China has a high debt-to-GDP ratio because most Chinese businesses are funded through loans rather than through the stock market, as in the U.S., and China's banks are able to engage in massive lending because the Chinese chiefly save their money in banks rather than investing it in the stock market, providing the deposit base to back this extensive lending. As for China's public "debt," most of it is money created on bank

balance sheets for economic stimulus. Zhao writes:

During the 2008-09 financial crisis, the U.S. government deficit shot up to about 10 percent of GDP due to bail-out programs like the TARP. In contrast, the Chinese government deficit during that period didn't change much. However, Chinese bank loan growth shot up to 40 percent while loan growth in the U.S. collapsed. These contrasting pictures suggest that most of China's four trillion RMB [RMB refers to renminbi, the official currency of the People's Republic of China] stimulus package was carried out by its state-owned banks. ... The so-called "bad debt problem" is effectively a consequence of Beijing's fiscal projects and thus should be treated as such.

China calls this government bank financing "lending," rather than "money printing," but the effect is very similar to what European central bankers are calling "[helicopter money](#)" for infrastructure—central bank-generated money that does not need to be repaid. If the Chinese loans get repaid, great; but if they don't, it's not considered a problem. Like helicopter money, the nonperforming loans merely leave extra money circulating in the marketplace, creating the extra "demand" needed to fill the gap between GDP and consumer purchasing power, something that is particularly necessary in an economy that is contracting due to shrinking global markets following the 2008-09 crisis.

In an article last December in the Financial Times, titled "Stop Worrying about Chinese Debt, a Crisis Is Not Brewing," Zhao expanded on these concepts, [writing](#):

[S]o-called credit risk in China is, in fact, sovereign risk. The Chinese government often relies on bank credit to finance government stimulus programmes. ... China's sovereign risk is extremely low. Importantly, the balance sheets of the Chinese state-owned banks, the government and the People's Bank of China are all interconnected. Under these circumstances, a debt crisis in China is almost impossible.

Chinese state-owned banks are not going to need a Wall Street-style bailout from the government. They are the government, and the Chinese government has a massive global account surplus. It is not going bankrupt any time soon.

What about the risk of inflation? As noted by the Citigroup economists, Chinese-style qualitative easing is actually less inflationary than the bank-focused quantitative easing engaged in by Western central banks. And Western-style quantitative easing has barely succeeded in reaching the Fed's 2 percent inflation target. For 2017, the [Chinese inflation rate](#) was a modest 1.8 percent.

What to Do When Congress Won't Act

Rather than regarding China as a national security threat and putting our resources into rebuilding our military defenses, we might get further ahead by studying its successful economic policies and adapting them to rebuild our own crumbling roads and bridges before it is too late. The U.S. government could set up a national infrastructure bank that lends just as China's big public banks do, or the Federal Reserve could do qualitative easing for infrastructure as the People's Bank of China does. The main roadblock to those solutions seems to be political. They would kill the privatization cash cow of the vested interests calling the shots behind the scenes.

What alternatives are left for cash-strapped state and local governments? Unlike the Fed, they cannot issue money directly, but they can establish their own banks. Fifty percent of the cost of infrastructure is financing, so having their own banks would allow them to [cut the cost](#) of infrastructure nearly in half. The savings on infrastructure projects with an income stream could

then be used to fund those critically necessary projects that lack an income stream.

For a model, they can look to the century-old Bank of North Dakota (BND), currently the nation's only publicly owned depository bank. The BND makes [2 percent loans](#) to local communities for infrastructure, far below the [12 percent average](#) sought by private equity firms. Yet, as noted in a 2014 Wall Street Journal article, the BND is [more profitable](#) than Goldman Sachs and JPMorgan Chase. Before submitting to exploitation by public-private partnerships, state and local governments would do well to give the BND model further study.

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