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China stiffing America for $100 billion in debt

Yet U.S. taxpayers helping Beijing as part of trillion-$ credit bailout

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By Bob Unruh

While Chinese companies are in line to benefit directly from U.S. taxpayers' $700 billion-plus bailout of Wall Street, Fannie Mae, Freddie Mac and other financial institutions, Beijing is stiffing the U.S. for $100 billion or more in unpaid debt.

The status of the Chinese economy, including its repudiated debt, has prompted one analyst to warn of an "ominous threat" involving China's finances and suggest the possibility of "a dramatic reversal" for the "so-called Chinese Miracle."

"One of the greatest problems facing China is the government's failure to acknowledge and effectively address the true extent of state institutions' bad debt," Kevin O'Brien writes in an article titled, "Reassessing China's Sovereign Risk: Emerging Global and Domestic Trends Threaten the 'Chinese Miracle."

O'Brien's report was published at a website for the Global Association of Risk Professionals, a not-for-profit independent trade association of risk management practitioners around the world. It has 77,000 members from fields such as banking, investment management and academics.

One problem that should be addressed, he writes, is the $260 billion in sovereign debt owed U.S. and other investors which China has said it simply won't repay.

"The repayment obligation was inherited by the People's Republic of China, when the communists took control in 1949. The successor government doctrine of settled international law affirms continuity of obligations among international recognized successive governments," O'Brien said.

"The PRC is the internationally recognized successor government … which contracted the credit sovereign debt … and which had a loan agreement that states that such debt is intended to be 'a binding engagement upon the Republic of China and its successors.'"

The bonds, however, were excluded from a 1979 settlement of Chinese debts and in 1987, China even "concluded a discriminatory settlement accord with bondholders in Great Britain – an agreement that excluded from settlement any bonds held by non-UK citizens."

Then in 2006, the Chinese Ministry of Finance issued an official communiqué addressed to "the Embassy of the United States of America in China," in which the Chinese government formally repudiated China's defaulted full faith and credit sovereign debt and announced that it would not repay any debt held by American citizens, O'Brien said.

The repudiation still stands, even though the China Economic Review confirmed that major Chinese banks own $8 billion in Fannie Mae and Freddie Mac securities that are the targets of bailout provisions.

"Bank of China said last month it owned $7.5 billion in Fannie and Freddie bonds," the report continued. "The bank also held $5.2 billion in mortgage-backed securities guaranteed by the two agencies."

Those owners will be among the beneficiaries of the overall bailout plan assembled by the government and funded by taxpayers to "rescue" bad debt created by an agenda of loaning money to "subprime" recipients who may not have had the wherewithal to repay the loans.

Recipients of the U.S. taxpayers' generosity also may include various private Chinese interests with investments in American real estate and mortgage.

As recently as three weeks ago, China Investment Corp. was in active discussions to buy into U.S. financial institutions, including Morgan Stanley.

All the while Congress has been aware of the Chinese default but unwilling to mandate action.

Elton Gallegly, a California Republican in Congress, called it the "China debt syndrome."

"After Saddam Hussein's government was replaced in Iraq, China demanded that the new government pay off the debt Saddam's regime ran up against China. China prevailed and is getting 100 percent of the more than $10 billion Iraq owes it," he said in a recent commentary.

"China, however, refuses to recognize the debt its current government inherited when the communists took control in 1949. That debt includes about $260 billion on bonds issued by the former Republic of China. Of that, more than 300 American citizens are owed nearly $100 billion from bonds on which the People's Republic of China has defaulted," the congressman wrote.

"It's time China owned up to its international obligations. Pressure is the only thing China understands. And pressure works. Americans weren't the only ones owed billions when the communists seized control. British citizens were among the bondholders communist China had been ignoring. That lasted until 1987, when Great Britain enacted a law denying Chinese access to British capital markets and China responded by negotiating a settlement to pay off the bonds," he wrote.

Now, he said, China is in negotiations with France on defaulted bonds but "continues to ignore the United States."

He said worse than the actual monetary loss is the message that suggests China "does not have to play by the rules when it competes in the global economy. This helps explain Beijing's refusal to abide by trade agreements, the manipulation of its currency, its underwriting of the genocidal regime in Sudan and its financial relationship with the terrorist-sponsoring government in Iran."

"To that list we can add China’s refusal to crack down on the widespread theft of intellectual property. The piracy of U.S. movies, books, music and other products is costing Americans billions of dollars each year," he said.

China, meanwhile, is boasting of its economy growth and influence. On a Chinese-promoted website today the headlines bragged: "China ranks among the world’s top 30 economies," "China Investment Corp to start investing in Japan stocks" and "China's ship industry strives for No. 1 spot."

A resolution similar to Gallegly's also has been introduced in the Senate. The plan by Sen. James Inhofe, R-Okla., targets China's attempt "to conceal its defaulted government debt from investors."

"The Senate measure labels China's present 'investment-grade' credit rating as artificial and in testimony before the Senate Banking Committee, SEC Chairman Christopher Cox acknowledged that wrongful actions by a credit rating agency may subject the agency to revocation of its SEC registration," an announcement said.

At Washington Watch, the criticism focused on the U.S. credit rating agencies that have allowed the situation to remain under the radar.

"In China's instance, the three largest rating agencies (Standard & Poor's, Moody's and Fitch) are accused of intentionally violating their published criteria and metrics," said the report. "Sovereign Advisers, a risk metrics firm assisting the defaulted creditors of the Chinese government, has performed comprehensive research on this matter and has provided the U.S. Congress and the Securities and Exchange Commission with evidence suggesting that the actions of Standard & Poor's and Moody's were intentionally designed to conceal the Chinese government's debt repudiation and establish an artificial sovereign benchmark in order to increase ratings revenue from expanded securities issuance by Chinese corporations."

On the Washington Watch website, several participants in an online discussion expressed concern over the situation.

"It is about time the PRC was made to pay for their financial indiscretions from the past," said one.

"The situation is crystal clear," said another. "China has an obligation and if it wishes to operate globally it must meet this and any other obligations."

"If it walks like a duck, quacks like a duck, looks like a duck. China's credibility should be disclosed so investors are aware of the risk. China needs to pay its debts," added another.

Gallegly's effort also was to encourage that knowledge among investors.

"This action will put all investors on notice that China has refused to honor its obligations in contravention of international law," he wrote. "It will also encourage China to negotiate in good faith with American bondholders to settle their claims on defaulted bonds."

O'Brien called China's actions "selective default."

He said that's "a practice whereby a government selectively defaults on one specific class of full faith and credit sovereign obligations … yet honors repayment to selected creditors of a separate class.."

"China's refusal to honor repayment of its full faith and credit sovereign debt to American bondholders is best characterized by a statement that appeared in a recent news article: 'When it comes to territory, China claims Tibet and Taiwan based on historical claims predating the current communist government assuming power, but when it comes to debts owed to American citizens, it's a different story," he wrote.