China's optimistic economic plans undermined by looming global recession

James Conachy
23 March 2001

The mounting signs of global recession place serious question marks over the Chinese government's new five-year economic plan and budgetary policy.

Premier Zhu Rongji delivered an outline of the plan to China's political elite during the first day of this year's National Peoples Congress (NPC) held in Beijing from March 5 to March 15. The proposals, which dominated the discussion at the assembly, envisage a 7 percent annual economic growth until 2005, raising China's Gross Domestic Product (GDP) by a third to over $US1.5 trillion.

The core assumptions by China's economic planners are that there will continue to be growing demand for Chinese exports on the world market and a massive increase in foreign direct investment (FDI) into the country.

Last year, exports grew by 27.8 percent to a record $249.2 billion, while imports increased 35.8 percent to $225.1 billion. The US and Japan were by far the largest markets for Chinese goods, much of which passed indirectly by way of Hong Kong. The US reported imports of $100 billion from China and Japan over $40 billion.

There are early but telling signs, however, that export growth is falling off. In January, Chinese exports to both the US and Japan grew by just 3.3 percent, year on year, as both the major economies slipped further toward recession. This compares with last year's annual export growth to the US and Japan of 24.2 percent and 28.5 percent respectively.

The export items that experienced the largest growth in 2000 were high-tech products (a 50 percent increase to $36 billion) along with electronics and machinery (a 36.9 percent growth to $105.3 billion). But these are precisely the items, particularly high-tech, most affected by the downturn in the US.

Equally questionable is the assumption by China's economists that FDI will increase by one third this year to well over $50 billion, and continue to rise. The projections are justified on the basis that major corporations will rush to take advantage of the opening of China's domestic economy under the terms of its entry into the World Trade Organisation.

However, foreign direct investment in China is slipping. Actual FDI in January and February was $4.6 billion, well below the government target of $6.8 billion. On current trends it is possible that investment will fall below $30 billion, the lowest level since 1994, as global economic activity dramatically slows.

Falling international share prices will also impact on China. In 2000, three Chinese corporations raised $12 billion through listings on Wall Street. China had intended to put another 30-50 companies onto the world stock markets, hoping to raise $25-30 billion to finance its modernisation agenda and restructuring. Song Guoqing, an economist for China Securities Exchange, warned: “Global markets are depressed right now. There's plenty of bad news floating around. Perhaps they will raise too little if they list now.”

There are other signs that China's economic position is weakening. Capital outflows, in the form of interest payments, profit and investment repatriations are on the increase. Last year, there was a $20 billion “gap” in China's national accounts. Despite trade surpluses and a high FDI figure in 2000, foreign exchange reserves increased by just $10.9 billion to $165.5 billion.

The impact of falling exports and FDI would be to reduce China's economic growth to the slowest rate since 1990. China's domestic economy has stagnated since 1997, with deflationary pressures giving rise to falling prices, low profitability and over-capacity.

A recent survey found that supply still exceeds demand for 90 percent of goods. Large-scale layoffs are underway throughout the country, with thousands of unprofitable companies being restructured or closed down. Leading Chinese economists such as Hu Angang consider the official urban unemployment figure of 3.1 percent to be far too low, with the real rate at least 8-9 percent and 13-15 percent in the old industrial north-east of China.

High unemployment and the end of previous social security guarantees have plunged large sections of the population into deep uncertainty. A spokesman for China's National Bureau of Statistics, Ye Zhen, told the *China Business Daily* earlier in the year: “The government cannot expect Chinese urban consumers to spend more because they have many more worries such as pensions, medical care and children's education”.

In rural China, populated by 900 million people, living standards are at best stagnant. Many regions have been plunged into decline by severe flooding or drought and there are an estimated 150 to 200 million unemployed or underemployed in rural areas.

In the course of his report, Zhu Rongji declared that “numerous problems exist in China's economic and social life”. He cited shortages of water and petroleum, ecological problems, growing unemployment and the slow income increase in rural and some urban areas. He said the domestic economy was plagued by accidents, corruption, waste, bureaucratism and “poor public order”.

As a result, the plan was forced to assume that domestic consumer demand and private investment within China would make minimal contributions to economic growth.

In order to offset the stagnant domestic market, the budget for 2001 envisages government expenditure of $211 billion. For the second year in a row, a budget deficit of over $30 billion is expected. But the deficit may prove to far higher, as it assumes substantial increases in government revenue due to higher corporate profitability and

crackdowns on corruption.

Much of the deficit spending has been allocated to public work projects such as the West-East gas pipeline, a railway to Tibet and major road construction. Since 1998 China has poured $180 billion into massive public works to create jobs and stimulate growth. As foreign debt increases, however, concerns are being raised over the unsustainable character of government policy.

Closures, mergers and sackings

Since 1995, while foreign investment and export drove growth and generated the bulk of employment, Beijing has sought to push through a massive restructuring of the previous regulated economy that was centred on state-owned, nationally orientated companies. Through mergers, bankruptcies and mass layoffs, the Beijing regime has aspired to forge a network of internationally competitive Chinese corporations, listed firstly on China's own stock markets, then internationally.

Zhu Rongji told the NPC that the government had to “open China wider to the world and break down institutional obstacles to the development of the productive forces.” These are code words for the closure of the remaining unprofitable state-owned industries.

Since 1998 China has forced the bankruptcy of over 1,000 large to medium state-owned enterprises (SOEs), according to the State Economic and Trade Commission. The *Peoples Daily* reported that these included 20 to 30 companies employing over 10,000 staff, such as Benxi Mining, which had 54,000 workers before being shut down. While estimates vary, as many as 35 million workers employed by SOEs have been laid off since 1998. Officials admit to 14 million layoffs in 1999 and 2000, with at least another 7 million to go this year.

Asset management companies (AMCs) are currently restructuring firms that have unpaid debts of $160 billion to China's four large state banks. The AMCs are converting the debt into equity where companies can be restructured and then selling them on to overseas or local entrepreneurs.

According to a *BusinessWeek* report, Cinda AMC boasts that 392 companies under its control have handed it equity of $20 billion, cut debt from 70 percent to 40 percent of assets and laid-off 330,000 workers. The largest of the AMCs, Huarong, has 70,000 companies as its debtors, including a staggering 25 percent of China's state-owned enterprises. The State Administration of Industry and Commerce revealed earlier this month that, by November, 40,000 small to medium state-owned enterprises had been privatised.

These changes have greatly accelerated the transformation of large sections of the Communist Party bureaucracy and political elite into a new, property-owning class. Even the state-run journal, *Zhongliu*, felt compelled to complain last year that businessmen made up half the membership of party branches in areas like Shanghai. Among the delegates at the NPC were at least 12 of China's 50 richest individuals.

Over the past five years, there has been a dramatic shift in the ownership of China's productive capacity. Wholly state-owned companies now account for just 28.7 percent of firms, compared with 47.1 percent in 1996. Whereas only 5 percent of Chinese firms in 1995 were shareholding, now 21.4 percent are. Privately-owned and foreign companies now account for over 50 percent of Chinese firms.

It is estimated that 20 percent of the population earn 42.4 percent of income, own 42.5 percent of all wealth and control 80 percent of bank savings deposits.

Under conditions where industry is stagnant and the banks are offering only 2.25 percent interest, the wealthy have pumped capital into the stock markets, not productive investment. There are now 58 million stock trading accounts in China owned by the rich and middle class of the coastal cities. Rampant speculation has seen shares on the Shanghai and Shenzhen stock exchanges soar. The capitalisation of China's stock markets reached $581 billion, or close to 60 percent of GDP by the end of 2000.

Three Chinese economists alarmed at the economic and social dangers of share speculation addressed an open letter to the National Peoples Congress warning:

“China's stock markets are heading for a crash similar to that in the United States in 1929 which caused the Great Depression and that in Japan in the 1990s. Over the last 10 years, China's stock markets have not played the role they should have. A huge amount of capital is not going into investment but into the stock market, pushing up prices artificially high. While industry shrinks, the markets have become a black hole sucking in capital...

“If this goes on, China will become a financial oligarchy which seizes the assets of society, worsening the gap between rich and poor, poisoning the social atmosphere and betraying the national interest.” The letter concluded by calling on the NPC to act against the “masters of the gambling casino”.

The problem is, however, that some of the “casino masters,” or at least their beneficiaries, are to be found in the NPC leadership itself. A revealing figure cited by the economists is that members of the NPC Standing Committee had earned over $12 million from trading stocks. This is in a country where the average industrial worker earns less than $1,000 a year and where, according to the World Bank, 106 million people survive on less than $1 per day.

An economic downturn and financial crisis would heighten the already explosive class and social tensions in China. It is noteworthy, therefore, that some of the greatest applause for Zhu Rongji's speech to the NPC came when he announced the raising of military wages and measures to improve “public security” and maintain “social stability”. Having seized the country's wealth, the emerging capitalist class is just as determined as its counterparts elsewhere to use whatever means necessary to hang onto it.