China’s huge stimulus package: Another sign of economic crisis

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A massive stimulus package of 4 trillion yuan or $US586 billion announced by the Chinese government on Sunday is a desperate attempt to reverse the country’s rapid economic slowdown. The two-year plan will focus on infrastructure projects and social spending aimed at boosting domestic demand, amid a faster-than-expected decline in exports and plunging real estate and share markets.

The package amounts to almost a fifth of China’s gross domestic product (GDP) and is expected to lift the annual growth rate by 2 percent. It will be used to build railways, subways and airports as well as to reconstruct earthquake-devastated areas of Sichuan province. Credit will be loosened, especially for agricultural and small and medium-sized firms. Business taxes will be reduced by 120 billion yuan annually, by allowing all industries to deduct spending on capital equipment. Spending on low-income housing, higher farm subsidies and social welfare measures is expected to boost consumer spending.

The State Council—China’s cabinet—declared in a statement, “Over the past two months, the global financial crisis has been intensifying daily”, therefore it was necessary to take “fast and heavy-handed” measures to stimulate the economy. However, the huge package cannot compensate for the impact of the developing recession in the US, Europe and Japan on Chinese exports and the inflow of foreign investment.

After growing at more than 10 percent a year for the past five years, the Chinese economy is slowing rapidly. The growth rate has fallen in every quarter since reaching a high point of 12.7 percent in the second quarter of 2007. For the third quarter of this year it hit 9 percent. An International Monetary Fund update released last week predicted that China would grow 8.5 percent next year even after factoring in a large stimulus package. Credit Suisse AG and UBS AG have foreshadowed a growth rate of 7.5 percent or less in 2009—the weakest figure since 1990. Some analysts predict growth as low as 5-6 percent.

While the stimulus package is huge, already doubts have been raised about its effectiveness. Xing Ziqiang, an economist at China International Capital Corp, told *Bloomberg.com* that the measures “can’t fight cyclical downturn and global demand is beyond the government’s control.” The continuing deteriorating position of the export sector, he added, would “translate into the loss of jobs, an issue that would worry the government more.”

The *Wall Street Journal* noted that China’s infrastructure spending had already been growing by about 20 percent a year in the past two decades, so “there may be physical and logistical limitations to how much spending can be further accelerated.” It predicted that China would experience at least one or two more quarters of slowing growth before the stimulus package had any impact.

The *Financial Times* pointed out that many aspects of the package remained unclear. Exactly how much new infrastructure spending is included, as opposed to projects already in the pipeline, is uncertain. Arthur Kroeber, managing director of Dragonomics, told the newspaper that the actual extra investment might be as little as one third of the headline figure—that is, only 1.3 trillion yuan.

The impact of the stimulus package is questionable in an economy that is structurally dependent on exports and therefore highly vulnerable to any downturn in export markets. A recent article in *Forbes* magazine explained: “[E]xports represent about 40 percent of the GDP. Real investment in China is about 45 percent of the GDP, and aside from housing and infrastructure spending, about half of this capital expenditure goes towards the production of new capital goods that produces more exportable goods. So, with the sum of exports and investment representing about 80 percent of GDP, most Chinese aggregate demand depends

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on its ability to sustain an export-based economic growth."

Growth in China's exports to the US—its main market—has fallen from 20 percent a year ago to zero so far this year. Negative growth is forecast for 2009. The prospects for Chinese exports to the European Union and Japan, and even to the so-called emerging economies are not so different.

Fearful of defaults and bankruptcies, major state banks are resisting Beijing's calls to facilitate lending to small firms. The China Banking Regulatory Commission reported that loans for small businesses by the country's 20 largest lenders rose just by 6.2 percent in the first half of this year—compared to 14.1 percent for their overall lending. Small firms account for 75 percent of urban jobs and 60 percent of the GDP.

Speculative capital is flooding out of the country, leading to sharply falling share and property prices. In September alone, an estimated $10-25 billion was pulled out, further depressing the real estate sector, which employs 10 percent of the workforce and accounts for a quarter of fixed asset investment. In turn, these declines will further depress demand for steel and cement where there is already massive overcapacity.

For all the current debate about the need to boost domestic consumption in China, the country functions as a gigantic cheap labour platform for global capital. Industrial expansion in China bears almost no relation to the consumption of the Chinese masses, which comprises just 35 percent of GDP, compared to 70 percent in the US.

The inflow of foreign capital has been premised on low wages—a key factor in continuing low domestic consumption. In 2005, Chinese wages accounted for just 11 percent of the GDP—compared to 50-60 percent in most developed countries. At the same time, the annual Hurun List of China's richest 1,000 individuals released in October still listed 101 US dollar billionaires--only five less than last year--despite the financial crisis.

Beijing has managed this staggering social inequality by providing jobs for the millions of new workers who join the workforce each year. But as the economy slows that will no longer be possible. It is generally estimated that China needs to continue to grow at 8 percent per year to prevent rising unemployment and widespread social unrest.

Factory closures are snowballing. Gao Jiahai, a researcher at the Chinese Academy of Social Sciences, told the *Boston Globe* that 67,000 factories were shut down in China during the first half of this year. By the year's end, the figure could well be over 100,000. Ye Hang, an economics professor at Zhejiang University, told the newspaper: "Honestly, I think whatever measures the government would take at the current stage would not turn around this trend. The government can only try its best to put out a fire here and there."

In Zhejiang province, manufacturing industry has been hit hard. Ye pointed to six major bankruptcies so far this year, including the Feiyue Group, China's largest sewing machine manufacturer, not to mention many small and medium firms. "Of these six," Ye said, "one [owner] committed suicide, one was detained by the police, and the remaining four all escaped."

Although China's bankruptcy laws give priority to unpaid workers, a growing number of factory owners have simply fled, leaving behind few assets. Unemployed workers are increasingly demanding that government, at all levels, cover their entitlements. While some workers have been paid in order to prevent angry protests, increasingly Beijing will rely on its police state apparatus to silence discontent and opposition.

Stockmarkets in China, across Asia, and internationally initially rose in anticipation that the Chinese stimulus package would give a boost to the slowing world economy. The burgeoning Chinese economy has in recent years become a key market for capital goods from countries such as Japan and Germany, and for parts and commodities from other Asian economies and Australia. The optimism is likely to quickly fade, however, as the limited capacity of the measures to boost growth in China, let alone the world, becomes evident.

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