China’s stimulus package threatens greater economic chaos

John Chan
25 November 2008

The Chinese state media announced last Sunday a huge increase in the stimulus package being proposed to reverse the country's economic slowdown. Provincial governments have drawn up plans that will bring total spending to 10 trillion yuan or $US1.5 trillion, more than twice the original program announced by the central government on November 9.

The announcement is another sign of increasing desperation in Beijing amid fears that the Chinese economy will slow to 8 percent or less next year and unleash a wave of unemployment. Far from solving the crisis, the latest measures could well intensify it. Concerns have already been expressed that the huge stimulus package will open the door for local and provincial officials to profit from wasteful projects that simply add to the country's massive overcapacity and place further burdens on the state banking system.

Beijing has already announced it will only finance a quarter of the original 4 trillion yuan package, leaving the remainder to local governments, state firms and banks. The result is likely to be another wave of speculative projects by local government, especially in real estate which has been a major source of revenue. In Shenzhen alone, new homes are being built with the expectation that they will not be sold for another 12 years.

The *Wall Street Journal* last week reported the comments of Frank Gong, a JPMorgan economist, who warned that provincial and local officials "have been waiting for years and years to get their turn to invest and build projects". Previously Beijing has been trying to rein in spending to try to prevent the economy from overheating. Now, Gong explained, the "investment rush can result in rising corruption cases and wasteful spending in an environment of deteriorating global demand".

A recent study by Nobuyuki Saji, chief economist for Mitsubishi UFJ Securities, found that existing overcapacity was putting China on the verge of a major deflationary spiral. He estimated that the Chinese economy is currently operating as much as 50 percent below capacity, due to previous vast expansion in many industries and the current sharp downturn in global demand. "In the end, the only realistic way of closing this gap will be a correction brought about by prices collapsing," he said, which in turn will accelerate the plant closures and job losses already underway.

An article in the *Caijing* financial magazine on November 11 provided an insight into the "fragile expansion" in the Yangtze River Delta that accounts for nearly a quarter of China's gross domestic product (GDP) and 30 percent of all private firms. "For many private firms... the apparent difficulties are slowing demand or tightening credit... But more fundamental causes are overcapacity created by excessive expansion," it stated. In recent years, rising prices for steel, real estate and chemical fibres and shortages of commodities attracted huge investment into these sectors. Now bankruptcies are spreading rapidly as firms are caught with mounting debts, amid the bursting of the property bubble, falling exports and collapsing prices.

Caijing explained that many large firms, with the backing of local government, had raised highly leveraged loans from the banks. A group of companies would each obtain loans by using each other's assets to make their collateral appear larger than it was. As long as the economy was expanding rapidly, the banks could continue to finance this debt-driven expansion. Once the economy started to slow, these firms quickly became enmeshed in deep trouble.

Another article in *Caijing* on November 14 pointed to the collapse of the "Suzhou model" in the Yangtze delta. The city of Suzhou was notorious for providing low-cost land and cheap loans to foreign investors with little start-up capital, particularly in the export sector. With the collapse of

© World Socialist Web Site

export markets, textile production in Suzhou has been cut by one third and profits have halved. A large number of manufacturing firms have collapsed or are leaving. Local banks are in a state of panic as foreign investors flee the area taking any remaining assets with them.

The fate of Suzhou and other industrial cities demonstrates the fragile character of Chinese capitalism, which rapidly expanded over the past decade on the basis of exports to the US and Europe. With all of the major economies, including the US, predicted to go into recession, investment-driven expansion in China is coming to a crashing halt.

Various commentators have been urging China to encourage domestic consumption. On November 17, however, Premier Wen Jiabao announced a freeze this year on any increase in minimum wages across China, after firms in the export sector demanded a cut in wages to avoid bankruptcy. Most workers receive little more than the minimum wage, which has actually declined in real terms over the past decade. In Guangdong, the minimum wage (the highest in China) is just 880 yuan ($US128) a month.

Social expenditure that could also boost consumer spending is still low in China. Just 11 percent of the national budget is devoted to social programs, despite China's budget surplus and huge foreign currency reserves of nearly $2 trillion. At the same time, the Chinese central bank continues to pour tens of billions of dollars into US treasury bonds and other investments, in order to keep the yuan relatively low against the US dollar and maintain the competitive edge of Chinese exports.

Social Unrest

There is a growing fear in Beijing that job losses will lead to social unrest. Yin Weimin, the minister of human resources and social security, last week described employment conditions in China as grim. "Our judgment is that in the first quarter of next year there will be even greater difficulties [for employment]," he said. The official unemployment rate of just 4 percent is a gross underestimation as it only includes registered urban workers, not the tens of millions of rural migrants employed in China's export industries.

Chinese officials have generally played down job losses. But Zhang Xiaojian, vice minister of human resources and social security, recently warned of falling job opportunities. In the third quarter, business demand for employees was down 5.5 percent from a year earlier—a sharp reversal of the second quarter gain of 4.7 percent. Zhang admitted that nearly half of the surveyed companies recorded net job losses for the quarter. He also noted that competition for jobs among millions of college graduates was intensifying.

The first to be hit will be migrant workers. The result will be falling income and rising unemployment in the most impoverished rural areas of China. Authorities in Hubei Province recently estimated that over one million laid-off migrant workers will head home before the Chinese New Year in January. In Chongqing municipality, more than 100,000 migrant workers have already returned.

A wave of protests has rocked China in recent weeks. Last week, 2,000 people rioted in Longnan, a city in Gansu Province, over the planned relocation of government offices to another city—a move that threatens to destroy jobs and drag down the housing market even further. The crowds swelled to more than 10,000, leading to violent clashes with police. For weeks, taxi drivers in a number of cities have staged strikes over rising fuel prices and corrupt collusion between officials and taxi fleet owners.

China's police state apparatus is already being primed to suppress social unrest. Zhou Yongkang, the member of the Chinese Communist Party's powerful Politburo Standing Committee in charge of state security, told a national conference on November 20 that an "all-out effort" was needed to strengthen the police, particularly in rural areas. "By doing so, we can nip [unrest] in the bud. We have to strengthen public security forces in rural areas, crack down on crimes in high places, and punish those who endanger our social stability," he declared.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site