Chinese leaders face bleak economic prospects

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Two national gatherings that began in Beijing last week—the Chinese People's Political Consultative Conference (CPPCC) and the National People's Congress (NPC)—are another indication that China is facing a deepening economic slowdown.

Desperate for any good news, share markets in Asia, Europe and North America rose last week on speculation that the Chinese leadership was about to double its 4 trillion yuan ($US585) stimulus package. *Dow Jones Newswires* reported: "Traders bet Beijing will step up its attempt to stimulate China's economy, buying shares of heavy-equipment, metals and oil companies."

In his opening report to the NPC on March 5, however, Premier Wen Jiabao made no mention of any new spending measures. Stock markets promptly slumped again. While the existing stimulus package has clearly not halted declining economic growth, Beijing is clearly worried about the financial dangers of more government spending.

The budget deficit is already forecast to rise to 950 billion yuan ($US140 billion) this year—more than eight times higher than in 2008 and the largest since the regime was established in 1949. The deficit is equivalent to nearly 3 percent of GDP, which is seen in China as the critical red line for financial instability.

With nearly $2 trillion in foreign currency reserves, China is widely regarded as being in a strong financial position. However, most of these reserves are invested in US treasury bonds and other assets in order to prevent the yuan rising against the US dollar and to keep Chinese exports competitive. Tax revenues are declining as export orders fall and the real estate market slumps. China's finances are not as solid as is commonly believed.

Premier Wen pledged to achieve 8 percent growth this year—the minimum level considered necessary to generate enough jobs to prevent social unrest. But his forecast of 9 million new urban jobs in 2009 is barely enough to absorb an estimated 7-8 million college graduates looking for work, let alone the millions of rural migrants and urban workers wanting a job.

Wen painted a gloomy picture: "Demand continues to shrink on international markets; the trend toward global deflation is obvious; and trade protectionism is resurging. The external economic environment has become more serious, and uncertainties have increased significantly."

All of the official figures are premised on a growth rate of 8 percent. However, the IMF predicted in February that growth in China would be just 6.7 percent in 2009—half the 13 percent achieved in 2007. Other analysts forecast growth of between 5-6 percent.

CPPCC chairman Jia Qingling pleaded with private businesses not to shed jobs. "We encourage people from the non-public sector... to shoulder their share of social responsibilities and work hard to ensure that no employees in their enterprises are laid off, or suffer pay cuts, or wage arrears, in order to create harmonious labour relations," he declared.

But more than 20 million rural migrant workers have already lost their jobs. Medium and small enterprises (SEMs), especially in the export sector, are being hit hard. According to the *Nanfan Daily* last month, 20,000 SEMs in Guangdong province have shut down since October, with the loss of 2 million jobs.

Lau Tat-pong, chairman of the Hong Kong Small and Medium Enterprise Association, told the *South China Morning Post* that Hong Kong-owned firms in the Pearl River Delta had been badly affected. In some manufacturing towns, only 20-30 percent were operating. Across the region, about 40 percent of the 65,000 factories were operating at just 50 percent of capacity. One-fifth had lost 30 percent of orders, while 30 percent had lost 10 percent of their business.

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Larger multinationals have also been forced to cut production and jobs. Intel is slashing 2,000 jobs in Shanghai and transferring its operation to Sichuan province where wages are cheaper. Last month, Panasonic Electronic Devices (Beijing) announced job cuts, as part of the Japanese corporation's plans for a 5 percent reduction in its global workforce.

The presidents of the country's five most prestigious universities warned last Friday that the top 500 multinationals operating in China have cut job opportunities for college graduates by 40 percent. Xu Xianming, president of Shandong University, said: "Such a decline has given us a warning that the global financial crisis is really coming. We have to prepare for the worst because the worst of the turmoil hasn't arrived yet."

The Purchasing Managers Index (PMI) rose in February to 49, up from 45.3 in January and an all-time low of 38.8 in November. The rise, however, is mainly the result of manufacturers stocking up on raw materials, rather than planning to expand production. A PMI reading below 50 means that manufacturing is contracting.

He Jiming from the China International Capital Corporation told the *Financial Times* last week: "Chinese GDP may continue to rebound robustly in the second quarter due to full fiscal stimulus effects. But it may decline remarkably in the fourth quarter due to falling credit, fading stimulus effects from infrastructure construction, and shrinking private demand."

Beijing is providing only one third of the stimulus package or $161 billion over two years, leaving the rest to state banks, firms and local governments. One third of new bank lending is believed to have gone into the share markets, rather than productive capacity, due to a lack of confidence in economic prospects. Of the 100 billion yuan allocated for the last quarter, only 30 billion has been disbursed.

Fearful of social unrest, the Chinese leadership has made some limited welfare proposals. A Social Security Law is being drawn up promising universal access to basic healthcare, workplace injury and unemployment insurance and pensions. As well as providing a social safety net, the law is aimed at boosting domestic consumer spending.

However, with declining tax revenues and falling profits across every section of industry, there is little room for making concessions to working people. A proposed increase in minimum wages across China was frozen in November, and a Labour Contract Law introduced in 2008 to provide basic legal protection for workers has been effectively suspended by many local governments.

Following public criticism, Wen announced that the proportion of the stimulus package to be spent on social programs would be increased from 1 to 4 percent. Spending on education this year will rise by 24 percent, healthcare by 38 percent and low cost housing for poor families by 171 percent. However, much of the increase is supposed to come from local governments, which are already in deep financial strife due to falling revenues.

The government has promised 850 billion yuan over the next three years to make healthcare affordable for working people, but 34.15 billion yuan or 6.9 percent has been announced in this year's budget. Even when the economy was booming, Beijing's pledges often failed to materialise. In 1997, Beijing promised to spend 4 percent of GDP on education by 2000. By 2007, the proportion was only 2.8 percent.

The regime confronts a dilemma. While under pressure to increase consumer spending as a means of halting the economic slowdown, any increase in wages will undermine China's position as the world's premier cheap labour platform. All levels of government are vying to offer tax concessions, cheap land and cheap labour to keep foreign investment flowing in.

The one area that Beijing has no hesitation in boosting spending is on the security forces. The military budget will increase by another 14.9 percent to $70.2 billion—making it 19 years of double-digit growth. The increase is not only to advance the regime's ambitions to make China a world power, but to strengthen the security apparatus to deal with social unrest that will inevitably erupt in response to falling living standards.

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