China offers no fix for global slump

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Any prospect that China could be the growth engine to pull the world economy out of deep recession has been laid to rest by the latest World Bank forecast.

At the recently completed annual National Peoples Congress (NPC), Chinese Premier Wen Jiabao promised the regime's policies would ensure 8 percent growth in 2009. The World Bank, however, cut its projection for this year to 6.5 percent, down from the previous 7.5 percent.

With the US, Europe and Japan all in recession, 6.5 percent sounds very positive. Reflecting the generally upbeat tone of the bank's outlook, World Bank country director David Dollar, described China as "a relative bright spot in an otherwise gloomy global economy".

The real situation and the scale of the economic slowdown in China, however, are underscored by the fact that 4.9 percentage points of the estimated growth will come from a massive government stimulus package. In other words, without the stimulus measures, the predicted growth rate would be just 1.6 percent—compared to 13 percent in 2007.

The World Bank's assumptions about China's $585 billion stimulus package are unlikely to be fulfilled. New state bank lending surged to $147 billion in February, up 24 percent from a year earlier, following a 21.3 percent rise in January. Yet industrial growth continues to slow and private investment is virtually stagnant. Lacking confidence about the future, many firms are using cheap loans to speculate on the stock market. The only growth areas are capital expenditure by large state enterprises and infrastructure spending.

These are all signs that much of China's vast export machine—the main motor for its spectacular economic growth—is rapidly grinding to a halt. In February, despite tax breaks and other government assistance, exports plunged 25.7 percent from a year earlier, far worse than the expected 1 percent growth. Moreover, imports fell by 24.1 percent in February, on top of a 43.1 percent decline in January, indicating that businesses regard economic prospects as bleak and are drastically cutting purchases of machinery, parts and raw materials.

The World Bank projection also assumes that China's export decline bottomed in February and will pick up as the global economy rebounds in the second half of 2009. This is little more than a stab in the dark. In its latest forecast for the world economy in 2009, released this week, the International Monetary Fund predicted a contraction of between 0.5 and 1 percent. For the advanced economies, which are China's main markets, the outlook was worse—an overall fall of between 3 and 3.5 percent. It was the fourth time in less than six months that the IMF has issued downward revisions.

For more than a decade, China has been held up as a shining example of the miracle of the capitalist market, particularly for the so-called emerging economies of Asia, Africa and Latin America. Its rise appeared to be unstoppable. In 2007, it became the third largest economy in the world, behind the US and Japan, with huge trade surpluses and foreign currency reserves.

When the sub-prime crisis hit the US in 2007, Chinese central bank governor Zhou Xiaochuan declared there would be only a "mild effect" on Chinese exports. Last October, as the world financial system appeared on the brink of meltdown, the *Financial Times* outlined "a master plan" for China to "bailout America" and speculated on the political conditions Beijing might impose.

All this is based, however, on the flawed assumption that "China" functions as an independent economic entity. The Chinese economy is an integral component of the world economy. The globalisation of production over the past three decades transformed the country into a giant cheap labour platform for transnational corporations. A significant portion of China's "exports" simply involves shifting goods geographically within the same company.

On closer inspection, the orgy of financial speculation in the US and the transformation of China into the sweatshop of the world were intimately related—two sides of the same coin. Driven by declining profit rates, US corporations turned to China to cut production costs. In turn, cheap goods from China kept real wages and inflation in the US low and allowed the Federal Reserve to operate a low interest rate regime that was the basis for the vast expansion of speculative profiteering. Consumer debt expanded, maintaining a market for Chinese goods. China's trade surpluses were invested back in the US to prevent the value of the yuan from rising and helped to prop up America's massive debt.

It appeared that the process would go on forever. The US Fed responded to the collapse of each speculative bubble by pumping more money into the financial system, confident that the continuing flow of cheap goods would prevent soaring inflation. Massive profits were made, based on mountains of fictitious capital in the form of exotic financial derivatives and packages. This whole precarious house of cards has now come crashing down.

For China, the collapse has resulted in a disastrous fall in exports as consumer spending in the US and Europe has contracted sharply. And China is not alone. All the export-driven economies of Asia are in the same predicament. The once booming intra-Asia trade, which supplied Chinese factories with components, raw materials and capital goods, is also imploding. Japan, Hong Kong, Taiwan, Singapore and South Korea are all formally in recession.

Now doubts are being raised about China's huge investments in US bonds and other securities. A new study by the US Council on Foreign Relations estimates that China's foreign currency reserves may be as high as $2.4 trillion—with $1.5 to $1.7 trillion held in various dollar assets. Last week, Premier Wen publicly expressed concerns about the security of China's investments if the US dollar dropped. This week, the US Fed compounded those fears with a plan, in essence, to print $300 billion to fund the US debt.

China is caught in a bind. If the US dollar plunges, Beijing faces losses that will destabilise its own financial and banking system. However, if it winds back its US investments, Beijing could trigger a global stampede to dump US assets, with potentially catastrophic consequences for the US and global financial system.

Addressing the National Peoples Congress, China's leaders attempted to put the best possible face on the deepening economic crisis. Wen assured delegates that 8 percent growth was achievable, promoted the regime's stimulus measures and announced new social welfare measures. Everyone present was well aware that anything less than 8 percent would mean rising unemployment and social unrest. Already 20 million rural migrant workers have lost their jobs and a growing army of urban workers, college graduates and demobilised soldiers are unable to find work.

Buried in the budget presented to the NPC was a significant item—a massive increase in spending on public security, by 20.5 percent to more than $71 billion. The figure is larger than China's total military budget of $70.2 billion for 2009. "We will improve the early warning system for social stability to actively prevent and properly handle all types of mass incidents," Wen blandly told the delegates. The purpose is all too evident—the linchpin of the "Chinese miracle" has been a pervasive police-state apparatus to suppress all criticism, political opposition, protests and strikes.

US, European and Japanese commentators routinely call into question the purpose of China's expanding military spending. None of them had anything to say about the public security budget. It is understood only too well in international financial circles that a social upheaval in China would reverberate around the world—politically and economically.

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