World Economic Forum: False hopes in a China-led recovery

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The World Economic Forum held in the Chinese city of Dalian on September 10-12 was attended by 1,400 business leaders, government officials and economists from around the world. Known as the annual "Summer Davos", the gathering is testimony to the growing international focus by the world's ruling elites on China as the prime engine of economic growth.

The Dalian forum started in 2007 as a supplement to the main World Economic Forum in Davos, Switzerland. The themes—"Shifting Power Equation" in 2007, followed by "The Next Wave of Growth" and this year "Re-launching Growth"—all underline the economic rise of China and its importance to global capitalism.

However, the reality is that China, despite its continuing growth, is beset by economic problems of its own. In his opening speech, Chinese Premier Wen Jiabao explained: "China's economic rebound is unstable, unbalanced and not yet solid." He pointed in particular to the "tremendous pressure" on China produced by the continuing global decline in demand for its exports.

Many economists expect that China will achieve this year's government target of 8 percent growth. At the same time, however, most of that growth is directly attributable to Beijing's huge 4 trillion yuan ($US585 billion) stimulus package and a massive surge in bank lending ($1.1 trillion in the first half of the year). Such measures are simply unsustainable in the long-term.

Wen emphasised that the government's priority was to maintain social stability by "taking all possible steps to expand employment." A recent report by the Chinese Academy of Social Sciences found that 41 million workers had lost their jobs since the global financial crisis erupted last year—equivalent to 40 percent of the world's total job losses. Of those who lost their jobs, 23 million were still out of work. Earlier figures released in August put job losses at 16.5 million.

Many CEOs, however, are banking on continued high growth rates in China. The so-called recovery being touted in the financial press of Asian economies, including Japan, South Korea and Taiwan, is largely based on increased exports to China. The Australian economy has been able to avoid a technical recession only as a result of continuing huge sales of raw materials to China.

James J. Schiro, the CEO of Zurich Financial Services, enthused at the forum: "Traditionally, the US economy pulls the global economy out of crises like this. But with rising unemployment and stalled consumer spending, the Chinese economy is returning to growth fastest. China will accelerate its importance as a result of this crisis." Klaus Schwab, the executive chairman of the World Economic Forum, told the *China Daily*: "The fact that the growth objective has been achieved underlines that China is performing better than others and will come out of the crisis first."

The latest Chinese figures released last week showed signs of growth. Industrial output in August grew by 12.3 percent from a year earlier, the fastest pace in 12 months, up from the 10.8 percent increase in July. Fixed-asset investment rose 33 percent year-on-year. New bank loans reached 410.4 billion yuan in August, up from 355.9 billion in July and 271.5 billion in August 2008.

However, the key export sector, which has been the main driver of economic growth, is still being dragged back by weak consumer demand in the US, Europe and Japan. Exports, while 3.4 percent higher than the comparable figure for July, declined by 23.4 percent year-on-year.

Morgan Stanley Asia chairman Stephen Roach told the *Financial Times*: "This [growth] trend is not sustainable and, although the Chinese economy will probably expand in the third and fourth quarters this year, the real test will be next year when it becomes clear that external demand, led by the US consumer, is in big trouble."

Writing in the *Financial Times* in July, Roach commented: "I've been an optimist on China. But I'm starting to worry." He pointed out that surging investment had accounted for an unprecedented 88 percent of China's economic growth in the first half of 2009—double the average contribution of 43 percent over the previous decade. He warned that the explosion of bank lending was only sowing the seeds for a huge rise in non-performing bank loans.

Roach warned: "A little over two years ago, Premier Wen Jiabao warned of a Chinese economy that was becoming increasingly 'unstable, unbalanced, uncoordinated and ultimately unsustainable'. Prescient words. Yet rather than act on those concerns by implementing a pro-consumption rebalancing, growth-hungry China was seduced by the boom in global trade and upped the ante on its most unbalanced sectors. By 2007, investment and exports accounted for about 80 percent of Chinese GDP. And now, in the face of a severe global recession, China has compounded the very problems the premier warned of: aiming a massive liquidity-driven stimulus at its most unbalanced sector."

At the forum, Premier Wen pledged to change China's growth dynamics from exports and investment to domestic consumption. However, any boost to domestic consumption would involve making substantial concessions to working people and would undermine China's position as the world's premier cheap labour platform. Many smaller Chinese companies are already operating on tight profit margins or have shut down completely.

Most stimulus spending has not been used to boost consumer spending, but to build infrastructure to lower manufacturing costs. The rail ministry plans to add 20,000 kilometres of track this year to the existing 80,000 kilometres, making China's rail network the second longest after the US. As for roads, China had just over 60,000 kilometres of highways last year—compared to 75,000 kilometres in the US. Over the next few years, it is estimated that China's road system will expand to 180,000 kilometres.

These huge construction projects have created demand for large state firms producing commodities such as cement and steel, but have done little for the vast number of small and medium enterprises that account for 75 percent of urban jobs. According to a study by the Chinese Academy of Social Sciences in June, 40 percent of all small and medium enterprises had shut, another 40 percent were struggling and only 20 percent were relatively unaffected by the global economic crisis.

In his forum speech, Premier Wen assured global investors that Beijing would not change the stimulus measures. "We cannot and will not change the direction of our policies when the conditions aren't appropriate," he said. However, fears that Beijing will be forced to tighten credit supply caused the highly-inflated Chinese stock markets to shed 20 percent in August. The flood of bank lending has led to rampant speculation in shares and real estate.

Manufacturers are also dependent on the stimulus measures such as car subsidies, which saw sales up 90 percent in August year-on-year. General Motors was forced into bankruptcy in the US but is now the largest foreign automaker in China, doubling its sales in August. With 12 million vehicles expected to be sold this year, China is likely to surpass the US as the world's largest auto market. However, as the *Wall Street Journal* noted, the strong growth at present is simply the result of lower taxes on car sales, which encourages consumers to bring forward their purchases. Next year the sales growth is expected to be just 2 percent, creating a huge production overcapacity.

China's prospects for reviving exports are running into a rising tide of protectionism. Less than 24 hours after Wen's speech, the US stoked trade tensions with China by imposing a 35 percent tariff on Chinese-made tyres. Beijing responded within hours by ordering investigations into imports of US-made auto parts and poultry products. With the G20 summit in Pittsburgh due next week, the US and China, along with virtually every other G20 member state, have dumped their previous promises to avoid protectionist measures.

Corporate leaders, officials and politicians gathered in Dalian to pay homage to China as the bright spot of global capitalism. However, closer examination reveals that despite its continued growth the Chinese economy is just as fragile as its counterparts in America and Europe. Far from being the engine that revives the global economy, a major crisis in China would well be the impetus that tips it over the edge into depression.