

Huge contradictions behind China's stimulus-driven recovery

John Chan**19 November 2009**

US President Obama's visit to China this week focussed attention on the country's rising economic power, high growth rates and large currency reserves amid the continuing global economic crisis. A closer examination, however, reveals that China's hothouse economy rests on fragile foundations.

A *Wall Street Journal* poll of prominent economic analysts in early November pointed to slowing growth in the second half of 2009 as Beijing's huge stimulus measures began to wane. China's official growth statistics are based on changes in gross domestic product (GDP) compared to the corresponding period of the previous year. The National Bureau of Statistics figure for the third quarter was 8.9 percent, following 7.9 percent in the second quarter, suggesting a steady trend of recovery.

However, the standard method of measuring growth rates in most major economies is quarter-on-quarter on a seasonally adjusted annualised basis. Making this adjustment, the *Wall Street Journal* survey predicted that China's growth would fall to 8.9 percent in 2010 from a peak of about 15 percent in mid-2009 and 9.5 percent in the final quarter. The survey was conducted among international institutions including Bank of America-Merrill Lynch, Barclays Capital, Capital Economics, China International Capital Corp., Citigroup, Deutsche Bank, Goldman Sachs, UBS and the Organisation for Economic Cooperation and Development.

While still strong compared to most other countries, China's slowing growth points to the limits of the government's 4 trillion yuan (\$US586 billion) stimulus package and loose lending policy since last November. Industrial production rose by 16.1 percent in October year-on-year, the fastest pace since March 2008, but exports continued to slide by 13.8 percent.

Even before the global financial crisis, there were huge overcapacities in industry resulting in low profitability. As a result, the flood of state bank credit unleashed last year has not gone into productive investment, but has fuelled rampant and unsustainable speculation in the stock and real estate markets. New bank loans in the first 10 months of 2009 reached \$1.3 trillion—a surge of 144 percent over the same period last year.

Property sales jumped by 82 percent in October year-on-year.

The *Financial Times* warned recently that China was heading for a "Japan-style bubble" like that of the late 1980s, which burst with a spectacular collapse of Japanese share and property values, leading to prolonged economic stagnation.

The article explained: "At the 2008 peak, the price-to-book ratio of the Shanghai stock exchange was more than 7 times, well above the 5 times achieved by Japanese stock in 1989. After the turbulence of the past 18 months, the ratio has fallen to 3.3 times, still the world's second highest after India, and residential real estate trades at multiples of income that make the US housing boom look tame." The price-to-book ratio, which compares market share prices to the net assets of firms, is an important indicator of share overvaluation.

The *Financial Times* warned that American pressure for the revaluation of the yuan against the US dollar would only fuel speculation in China and exacerbate the dangers of a financial collapse. It pointed out that the implosion in Japan in 1989-90 took place after the revaluation of the Japanese yen, under the 1985 Plaza Accord, set off "a Godzilla-sized credit binge".

The International Monetary Fund (IMF) and World Bank are both urging caution. The World Bank's China economist Ardo Hansson called for Beijing to tighten monetary policy before other countries. The World Bank is concerned that China's cheap credit is also fuelling equity and housing bubbles in other parts of Asia, especially Hong Kong and Singapore. It also pointed out that the projected growth of 7.8 percent in 2009 for East Asia was heavily dependent on China. Without China, the figure would be just 1 percent.

The IMF is arguing, however, that China and other Asian countries should maintain their stimulus spending to counter slow demand for their exports. Asian governments have spent more than \$950 billion in stimulus measures, but still have not compensated for slower consumer spending on their exports in the US and Europe. The G7 advanced economies are expected to grow by only 1.25 percent next year.

The IMF acknowledged that “striking the right balance will be difficult” between continued stimulus measures and financial instability. Beijing’s financial position, and thus its ability to sustain large stimulus spending, is not as solid as widely portrayed. Officially, China’s public debt is just 5.3 trillion yuan or less than 18 percent of the GDP—far less than US (more than 80 percent of the GDP) or Japan (approaching 200 percent). But the actual size of China’s debt could be higher.

The *South China Morning Post* explained: “Estimating how much higher is tricky, but the true number should include the off-budget debts of local governments, bad loans held by state asset management companies and on the books of state-owned banks, and the state sector’s unfunded pension liabilities. The Finance Ministry’s Research Institute for Fiscal Science has estimated the hidden debts of local governments at four trillion yuan. The International Monetary Fund estimated the legacy cost to the government of state banks’ non-performing loans as about 3.7 trillion yuan. And estimates of the present value of the state’s unfunded pension liabilities range anywhere from 1.3 trillion to 2.5 trillion yuan.”

In total, China’s real public debt is probably between 48 and 52 percent of GDP, not taking into account vast new bad loans from recent lending. Beijing has set a target of 10 trillion yuan in loans for 2009 and a similar amount for 2010. According to Morgan Stanley economist Wang Qing, some 5.5 trillion yuan could turn out to be bad loans, pushing Chinese government debt up to 55 percent of the GDP next year—in the same league as debt-stricken Britain.

Wang argued that the Chinese regime could always pay off its debts by selling tens of trillions of yuan in state assets—both enterprises and land. That only means another round of privatisations on top of more than two decades of plundering the state sector, which has led to huge job losses and the erosion of workers’ conditions.

The contradictions of Chinese capitalism are rooted in its position in the global division of labour as a low-cost manufacturing platform for the world’s major corporations to export to the US and other major markets. The economy is disproportionately based on manufacturing and fixed asset investment. The relatively small proportion going to consumption is the product of the deliberate suppression of wages to create an abundant supply of cheap labour. The imbalances are underscored by a 13.7 percentage-point decline in the share of GDP going to wages between 1997 and 2007, and corresponding 10.1 percentage-point rise in the share going to corporate profits.

China’s rapid economic growth over the past decade was dependent on rising consumption in the US and Europe, which has now been limited by falling real wages and high household debt. Workers in China did not benefit from China’s huge export earnings and high corporate savings, which were channelled back into the US to keep the yuan’s exchange rate low and Chinese goods relatively competitive. As a result, the US was able to finance its rising deficits and keep interest rates low, which in turn underpinned the rampant speculation on Wall Street.

These interconnected processes were shattered by the 2008 global crisis. Far from reversing the previous imbalances, Beijing’s stimulus package has propped up major corporations with export subsidies and incentives for car sales, and above all, through infrastructure projects for steel and cement industries. Only 20 percent of the package was allocated to social programs that would boost domestic spending. Most new bank loans were not taken by small and medium enterprises that employ the bulk of workers, but by large state, private and foreign corporations with close connections to the regime. As a result, 90 percent of the GDP growth in the first seven months of this year was driven by fixed asset investment, compounding existing overcapacity.

Social inequality is deepening. The stimulus package helped to expand the list of Chinese dollar billionaires from 101 last year to 130 this year. At the same time, the Chinese Academy of Social Sciences estimated in September that 41 million Chinese workers had lost their jobs, mostly in the export sector, since the beginning of the financial crisis, or 40 percent of the world’s total job losses.

As the impact of the stimulus package starts to wane, China confronts the prospect of falling growth rates and the danger of financial turmoil as well as rising social tensions and instability.



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