Chinese premier warns of global consequences of currency wars

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22 October 2010

In a speech in Brussels earlier this month, Chinese Premier Wen Jiabao appealed to European political and business leaders not to join the Obama administration's campaign for a major revaluation of the Chinese currency. After pointing out that such a currency shift would send many Chinese exporters to the wall, he warned: "Should China have problems in economy and society, it will be disastrous for the world."

According to the latest data, the Chinese economy continued to surge by 9.6 percent in the third quarter, down slightly from the second quarter growth rate of 10.3 percent. Wen's comments, however, point not only to the fragile character of Chinese capitalism, but to the extreme social tensions that threaten to explode.

Wen explained that many export firms have profit margins of just 2-3 percent or 5 percent at most. "Should the yuan appreciate by 20 to 40 percent, as demanded by some people, a large number of Chinese export enterprises will go bankrupt, the workers will lose their jobs and the migrant workers will have to go back to the countryside, making it hard for society to remain stable," he said.

"The world will by no means benefit from a crisis in the Chinese economy," Wen continued. "China contributed about 50 percent of the global economic growth in 2009. It is a huge market with great potential for many enterprises. Once again, I would like to tell our friends in the industrial and business community candidly: Don't pressure China on the appreciation of the Chinese yuan."

Wen's comments are not so much a threat, as a warning. The Chinese regime is acutely aware of the precarious nature of the economy and the social time bomb on which it is sitting. At the root of China's economic weakness is its role as the world's premier cheap labour platform for major global corporations.

Chinese exporters operate on narrow profit margins, because the prices of their products are dictated by their overseas corporate customers who, in many cases, can easily switch their orders to other low-wage countries such as Vietnam. In almost every Chinese industry, there is already vast overcapacity, resulting in intense competition between companies for overseas orders. These firms are also being squeezed by high commodity prices and rising wages.

The vulnerability of Chinese companies is illustrated by the solar battery industry, which accounts for 37 percent of global output and employs 300,000 workers. Solar battery exports grew more than 10-fold from 2005 to 2009, to $15 billion a year. China is the home to four of the world's 10 largest solar battery companies. Behind these impressive statistics, however, Chinese companies are still mainly low-end assemblers, dependent on imported equipment and components. Amid the global financial crisis in 2009, more than 200 firms had to suspend production or close down, due to falling export orders. Only 70 continued to operate normally.

The huge sweatshops operated by Foxconn are another example. The company employs nearly a million workers in some of the biggest factories in the world to assemble electronic products for big name corporations such as Apple, Dell and Sony. The low pay and oppressive military-style conditions were highlighted earlier this year by a series of suicides by young Foxconn employees.

Despite its vast scale of production, Foxconn and other electronics manufacturing service (EMS) sector companies are based on thin profit margins. According to one estimate, if a product is worth $US10, an EMS manufacturer makes only a few cents in net profit. Most of the profit flows to the multinational corporations that control the processes of design, components procurement, transportation and global marketing.

Foxconn's net profit for the first quarter of 2010 was 3.3 percent. This year's expected revaluation of the yuan by 2-3 percent threatens to wipe out the company's annual profit. Among the EMS firms, the average profit margin fell from 6.2 percent in 2006 to less than 3 percent in 2007, where it remains.

Low profits and grim export prospects are driving capital from manufacturing into speculation on China's inflated and unstable housing market. The huge domestic appliance sector, where profit margins are 2-3 percent, is in the forefront.

The state-run *Economic Information* newspaper warned last month: “As a large amount of the home appliance sector’s mobile capital is flowing into real estate, re-investment for the home appliance industry will be reduced significantly and the overall liquidity for the industry will be greatly weakened. If there is a turbulence such as the global financial crisis, these enterprises will face a huge cash flow test, making previously money-making real estate investment a ‘poison’ that will hinder the development of the main home appliance business.”

Chinese economist Dee Woo summed up the considerations behind Beijing’s currency policy in the *Wall Street Journal* on October 8: “Yes, a strong yuan would help the Chinese economy be less labour intensive and more capital intensive, which would move China up the international economic food chain. But China hasn’t found a model better able to absorb its abundance of employment seekers than labor-intensive production.”

Woo highlighted the political dangers: “Building a harmonious society is the Chinese government’s most important imperative. Once a Chinese person can make a living, he rarely challenges authority. No one should ever underestimate the Chinese government’s determination to defend the bottom line.” In other words, if huge numbers of Chinese firms are bankrupted and unemployment skyrockets, working people will challenge the regime’s authority.

During late 2008 and early 2009, more than 20 million migrant workers lost their jobs, mainly in export industries. Beijing was able to stabilise the economy only through a flood of cheap credit from state banks, a massive infrastructure building program and subsidies to manufacturers. At the same time, it intervened to ensure that the yuan remained relatively cheap against the US dollar, in order to assist Chinese exports.

These measures have kept the Chinese economy growing at around 10 percent but compounded the dilemmas facing Beijing. The intensifying US campaign against China on the currency issue is part of mounting rivalry between the two powers on a number of fronts. The US views China’s economic expansion as a challenge to America’s waning global position. The Obama administration has threatened to brand China as a “currency manipulator”, which would open the door for retaliatory measures.

China’s massive $585 billion stimulus package has only exacerbated industrial overcapacity and the pressure to export—at a time when all the major economies are doing the same. Beijing’s “Buy China” policy of using government procurement deals to boost emerging Chinese corporations, has pushed some foreign transnational corporations, which have traditionally opposed protectionism against China, toward the protectionist camp.

The government’s expansion of bank lending has led to a speculative frenzy in real estate. When the housing bubble collapses, it will reverberate throughout the country’s banking and finance sectors. According to Fitch Ratings last week, if local government investment in real estate is included, China’s general public debt stands at 32 to 47 percent of gross domestic product. The *China Security Journal* warned last week that of the $1.15 trillion in outstanding local government loans, 26 percent were highly likely to go bad.

Speculation in China is being fuelled in part by Washington’s policy of “quantitative easing”, which is flooding emerging markets like China with US dollars. According to the Peoples Bank of China, 120 billion yuan ($US18 billion) in “hot money” flowed into the country in September, double the August figure.

Beijing’s main fear, however, is that any economic downturn will trigger social and political unrest. Already there were strikes by workers in May and June, demanding higher wages in automobile and electronics factories. This industrial action remained on a relatively small scale and was confined to economic demands. If significant sections of China’s 400 million workers begin to take industrial and political action then, as Wen warned, the shock wave will be felt throughout the global capitalist system.