China imposes price controls as inflation threatens social unrest

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China's cabinet, the State Council, announced on November 17 that price controls were being adopted to stem inflation, which historically has been a major factor in triggering social unrest in the country. Two days later, the Chinese central bank raised the banking system's capital reserve requirement—for the fifth time this year—to rein in bank lending that is fuelling speculative rises in property prices.

According to the National Bureau of Statistics, China's consumer price index (CPI) increased 4.4 percent in October from the same period last year—the highest rise in 25 months. Food prices soared by as much as 10.1 percent. Inflationary pressures will increase over the coming months, with high demand during the New Year and Chinese New Year season, exacerbated by the difficulties of transporting agricultural produce to urban areas in winter.

The most likely targets of the price controls will be items immediately connected to daily life, such as grain, cooking oil, meat, eggs and milk, as was the case when similar measures were imposed in 2004 and 2008. In some cities, such as Fuzhou in Fujian province, price restrictions have already been imposed on four main vegetables. Beijing is also seeking to control rising utility prices through temporary subsidies of coal, oil and gas.

The State Administration of Grain started selling corn, soybeans and vegetable oil from its strategic reserves last week to stabilise prices. The State Council has also ordered local governments to ban toll collections on trucks transporting agricultural produce, and to crack down on speculation and the hoarding of commodities such as sugar and cotton. The China Banking Regulatory Commission has urged banks to provide additional lending to the agricultural sector, while admitting there is a severe shortage of corn, cotton and other crops.

Reports have emerged that students at a high school in the impoverished southwest province of Guizhou rioted this month over a second increase of cafeteria food prices this year. The broader fear in the Chinese government is that inflation could lead to protests by urban workers whose living standards are being eroded by price increases. Wang Yanling, a fruit stand owner in a food market in Beijing's Deshengmeng Avenue, told *Bloomberg News* last week that sales of apples had dropped from as much as 250 kilograms per day a year ago to just 100 kilograms, after prices soared over 60 percent. "People are buying less with prices jumping up," he said.

In 1989, inflation was a major factor in the mass movement that developed against the regime and which was only ended by the brutal military crackdown in Tiananmen Square. This year, there have been clear signals of developing militancy in the working class. In May-June, a wave of strikes by young workers in auto and electronics plants forced employers to raise basic wages, but often at the expense of other bonuses and with increased workloads. Just two days after Beijing announced the price controls, 7,000 workers at an affiliate of electronics giant Foxconn in Foshan in southern China, took to the streets, protesting over poor pay and the company's plans to relocate factories to inland provinces where labour is cheaper.

The anti-inflation measures will have contradictory effects. Even if they temporarily slow price rises in urban areas, price caps will aggravate social discontent among hundreds millions of farmers, from small vegetable growers to peasant households selling pork. They are paying more for manufactured goods but will not be able to sustain their living standards by charging more for their produce. Such conditions can cause farmers to cut back their production or hoard, leading to supply shortages and even greater pressure on prices in black markets outside official control.

Moreover, the pricing measures cannot counteract the vast global economic forces working beyond the national borders of China. Food prices are rising internationally due to rampant speculation in commodity markets. Neil Watkins, a director of ActionAid, told *Asia Times Online* recently: “As more and more investors get involved in commodity markets, [food markets] are being pulled away from real purchasers and sellers and more into the financial world.”

Soaring food prices sparked riots in several poverty-stricken countries in 2007-2008. Last month, the World Bank reactivated its Global Food Crisis Response Program (GFCRP), giving $760 million to countries at the risk of food price volatility. Major flooding in Thailand and Vietnam, two of the world’s largest exporters of rice, is predicted to cause a significant slump in world rice production and the World Bank expects volatile food prices until at least 2015.

Inflationary pressures are also being fuelled by the measures taken by the Chinese government in response to the 2008 global financial meltdown. Since late 2008, Beijing has pumped some 4 trillion yuan ($US600 billion) in stimulus spending into the economy. The total stimulus reached to 10 trillion yuan as a result of a frenzy of state-ordered bank lending.

Earlier this month, Professor Li Daokui, an adviser to the central bank, estimated that China’s total money supply had reached $10 trillion in September, or as much as 200 percent of gross domestic product (GDP). This compares with 60 percent in the US, 80 percent in South Korea and India, and 100 percent in Japan. The People’s Bank of China data provided an indicator of the massive growth of so-called M2 (cash or near-cash forms of money). The M2 had grown from 21.92 trillion yuan ($US3.34 trillion) in 2003 to 61 trillion yuan in 2009—almost tripling in six years.

Lower profitability in manufacturing has driven businesses into property and stock speculation. Average housing prices in China have tripled since 2005. In major cities such as Beijing, the ratio of home prices compared with average incomes had reached 27 to 1—five times the international figure—making a house purchase almost impossible for urban workers. Property speculation is fuelling widespread resentment toward wealthy developers and corrupt officials who are amassing huge fortunes.

The Chinese regime is facing a dilemma. It cannot afford to rein in real estate speculation too quickly because it depends on high growth rates to keep unemployment under control, and the construction industry is one of the largest employers. At the same time, the government’s tight control of its currency exchange rate to maintain export competitiveness means it cannot stabilise domestic prices by revaluing the currency to lower the cost of imports.

On October 28, the Chinese central bank lifted the one-year deposit rate—the benchmark interest rate—to 2.5 percent and the one-year lending rate to 5.56 percent, to curb property speculation. Many of the world’s largest investment banks have forecast that China will have another 0.25 percent rate rise before the end of this year.

China’s credit tightening has sent shock waves through global share and commodities markets in recent weeks, due to the fears it will impact on economic growth. China’s construction industry in particular, consumes 40 percent of the world’s steel and cement every year. China’s GDP growth is beginning to slow, with the economy expanding 9.6 percent in the third quarter, compared with 10.3 percent in the second and 11.9 percent in the first.

Many analysts expect China’s real estate market to slump due to the tightening of lending and other measures. A report by Goldman Sachs in early October predicted a 20 percent drop in housing prices over the next 12 months. A report by the Chinese Academy of Social Science on October 21 predicted property prices may fall 20 percent in the first half of 2011.

Any property market slump will create a debt crisis for many local governments, which set up investment companies to tap into the stimulus lending and invested in infrastructure and speculative real estate projects. An official investigation in October found that local governments were unable to fully meet repayments on half of the 7.66 trillion yuan they were lent. It is estimated that 26 percent of the loans will never be repaid.

China’s financial instability is another measure of the deepening global economic crisis and sharpening social antagonisms. Beijing’s measures to control inflation and speculation could slash growth sharply leading to rising unemployment, poverty and social discontent.