China’s mountain of debt

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For nearly three years, China with its rapid growth rates has appeared to avoid the worst global economic crisis since the 1930s. However, the very means used by Beijing to stave off a slump—cheap credit and huge stimulus packages—have generated bad debts that threaten to create new financial and economic instability in China and internationally.

The debt is centred in local governments that have borrowed heavily to invest in property and infrastructure. The first-ever statistics on local government debt released by the National Audit Office (NAO) at the end of June found staggering liabilities of 10.7 trillion yuan or $US1.65 trillion—equivalent to around 27 percent of the country’s GDP in 2010.

The international rating agency, Moody’s, last week put the debt total some $540 billion higher than the NAO figure, with bad debts estimated to be 8-12 percent of the total. Moody’s warned that in the absence of a plan to rein in local government debt, the agency’s credit outlook for Chinese banks had the potential to turn negative.

Victor Shih, a US-based expert on China’s local government debt, claims the total could be even higher at 15.4 to 20.1 trillion yuan, or 40 to 50 percent of China’s 2010 GDP. Moreover, as he told the *New York Times*: “Most of the government entities that borrow can’t even make the interest payments on the loans.”

Massive local government spending has helped fuel property speculation that has resulted in soaring property prices and a huge surplus of housing stock. Over the past decade, property prices in the growth centre of Shanghai have almost quadrupled. In Guangzhou they have trebled. In a report this year, the investment bank Credit Suisse identified Wuhan as one of China’s “top 10 cities to avoid,” explaining that it would take eight years just to sell off its existing housing stock.

The local government debt crisis is a direct product of Beijing’s response to the global financial turmoil that erupted in 2008. The sharp downturn in China’s major export markets—the US, Europe and Japan—led to the rapid loss of 23 million jobs. Fearful of social unrest, the Chinese regime outlined a stimulus program of 4 trillion yuan to maintain economic growth, while only providing 1.2 trillion yuan and leaving the rest to local authorities and state enterprises to finance.

The result was an orgy of borrowing. Banned from directly issuing bonds, local authorities set up investment companies to borrow from state-owned banks. The money did not go into desperately-needed public hospitals and schools, but real estate and infrastructure projects. Beijing encouraged the binge by promoting officials on the basis of local economic growth statistics.

The local government debt figures dramatically alter the picture of China’s public finances. Central government debt amounts to less than 20 percent of GDP—far lower than the levels of public debt in the US and Europe. However, as American academic Minxin Pei pointed out in a recent article, “China’s ticking debt bomb,” once local government debt and other liabilities are factored in, China’s total debt jumps to 70 to 80 percent of GDP.

Beijing has taken steps to tighten credit, which will make it more difficult for local governments to simply roll over their loans, about half of which come due in the next two years. A recent report from the investment bank UBS predicted that local government investment corporations could generate up to $460 billion in loan defaults over the next few years. If the central government is forced to bail out local authorities and banks, economic growth, which is already slowing, is likely to fall further.

In the past, Chinese local government finances would barely have rated a mention in the international financial press. It is a measure of global capitalism's dependence on economic growth in China that the debt levels are provoking concern over the ramifications for the world economy.

During the past two decades, high levels of growth have catapulted China from the world's 10th largest economy to the 2nd largest. According to a report by the Chinese Academy of Social Science in April, China last year contributed more than 30 percent of global economic growth. With the US, Japan and Europe stagnating, any slowdown in the Chinese economy will only compound the ongoing global economic crisis. Major commodity producers such as Australia and Brazil will be among the first impacted.

Within China, the costs of any bailout of local governments and the banks inevitably will be imposed, in one way or another, on ordinary working people, further fuelling social tensions. After the Asian financial crisis of 1997-98, Beijing was compelled to prop up the banking system by taking over $335 billion in bad loans from major state banks. To pay for the bailout, the regime privatised state enterprises—destroying more than 20 million jobs—abolished public housing and instituted "user pays" for health and education, vastly increasing the burden on the working class.

China's current debt crisis is on a far larger scale. Any economic slowdown will quickly lead to rising unemployment. There is already considerable social discontent over rising prices, with the consumer price index rising by 6.4 percent year-on-year—the highest rate in three years. Food rose by 14 percent, with pork up by 57 percent. Further economic burdens have the potential to trigger what the regime has always feared: an eruption of resistance and opposition by the working class, which is now 400 million strong.

Continued strong growth in China over the past three years has led some commentators to speculate that it offers an entirely new model of economic development. In reality, China is embroiled in the same global contradictions of capitalism that have produced the international economic crisis. Far from providing a new source of strength for world capitalism, China is proving to be an economic giant with feet of clay.

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