The significance of the Chinese stock market rout

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The ongoing fall of the Chinese stock market, despite strenuous efforts by government and financial authorities to bring it to a halt, has major economic and political implications, both within China and globally.

Yesterday, Chinese stocks again fell, with the Shanghai Composite Index down by 1.3 percent and the Shenzhen Composite losing 5.3 percent. Today, Shanghai opened down 8 percent before the losses were cut back to 4.7 percent by midday. Shenzhen also lost 3.3 percent. Even more significant was the announcement that trading in 1,476 stocks—more than 50 percent of all listed companies on China's two principal exchanges—had been suspended, freezing $2.6 trillion worth of equity.

The further declines this week have come in the wake of emergency meetings over the weekend between Chinese Premier Li Keqiang and banking officials and financial regulators. As a result of their deliberations, the central bank was given authority to provide virtually unlimited liquidity to China Securities Finance, a state entity, to finance brokerage houses and uphold "market stability." So far, the emergency measures have proved to be of no avail.

With China now the world's second largest economy—the largest according to some measures—and the source of at least 30 percent of global economic growth, there are rising concerns that the fallout from the stock market plunge will spread to the rest of the economy and impact the world at large. Significantly, copper price futures dropped to their lowest level since 2009 yesterday, after falling 8.4 percent during the past two days.

"Doctor Copper," as it is sometimes called within financial circles, is regarded as a key economic indicator. As the world's major manufacturing centre, China is the largest consumer of the metal. Iron ore and oil prices have also fallen on the back of the stock market crash.

The roots of the stock market crisis lie not in the Chinese economy as such, but in the breakdown of the global capitalist system that began with the financial meltdown of 2008.

Its impact on China was immediate. With the collapse of world trade in the latter part of 2008 and the early months of 2009—at one point, the rate of decline was on a par with that experienced in the early 1930s—Chinese exports plunged, leading to the loss of 23 million jobs.

Confronting a potentially explosive social crisis, the Chinese regime responded with a $500 billion stimulus package, coupled with a massive expansion of credit to local government authorities to undertake infrastructure projects and real estate development. New urban complexes and, in some cases, virtually entire cities, sprang up almost overnight. The regime entertained the hope that the world economy was experiencing a cyclical downturn and the previous expansion would resume.

But the events of 2008 marked the end of the conditions that, over the previous two decades, had enabled ever-expanding exports into the markets of Europe and the United States to power Chinese growth. Today, expanding exports contribute very little to China's economic growth.

For a time, expanding credit-fuelled infrastructure and real estate development boosted the Chinese economy, sustaining its expansion at, or near, the pre-2008 rates. This prompted the claim by short-sighted economic pundits that, despite the financial collapse, capitalism had yet again demonstrated its inherent resilience, because China, along with other so-called emerging markets, would provide a new basis for global growth. This prognosis was rapidly exposed, and is now officially acknowledged by the International Monetary Fund and other global economic authorities to have been a chimera.

The Chinese government recognised that the structure of the economy, in which investment, backed by credit, comprised around 50 percent of gross domestic product (GDP), while consumption spending accounted for barely 35 percent, was ultimately unviable.

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Consequently, in 2013, the regime initiated a new economic orientation, declaring that henceforth market forces would play an even more "decisive role." Setting out his agenda in November 2013, at a major meeting of the Communist Party leadership, President Xi Jinping, who had come to power the previous March, declared: "We must deepen economic system reform by centering on the decisive role of the market in allocating resources…"

The new orientation was comprised of two key components: lessening state intervention in controlling the financial system, which would increasingly be opened up to international capital flows; and lifting the level of consumption spending in the domestic Chinese economy.

An obvious way to boost domestic spending would be to increase the wages of the multi-millioned Chinese working class. But this road was closed off by the competitive struggle on global capitalist markets.

Any significant rise in workers' wages would mean that Chinese manufacturing firms, which operate on low profit margins as they carry out contracts for major US- and European-based transnational corporations, would be priced out of the markets by cheaper investment sites in Southeast Asia, such as Vietnam. With the suppression of American wages under the Obama administration, Chinese firms even face competition from the United States, which has, itself, become a cheap labour site.

For this reason, the regime, which rules in the interests of the oligarchs who dominate the upper echelons of the Chinese Communist Party, sought to boost consumption spending by another route. It set out to create a "wealth effect," by encouraging privileged sections of the middle class to invest in the stock market. It lured small investors into the market with the implicit guarantee that the Chinese government, its hands firmly in control of the levers of the financial system, would secure their investments.

The result was a flood of money into the stock market, lifting the Shanghai index by more than 150 percent in the year before it reached its peak on June 12. Much of this investment was provided through margin loans, in which the shares purchased by investors provide the collateral for the loans they receive, with the proviso that a portion of the debt will have to be repaid if the shares lose a certain amount of value.

These loans boost the market during an upswing but exacerbate any fall, with investors confronted by margin calls having to sell some of their shares to meet their debts, thereby creating a downward spiral.

Last April, with margin loans roaring ahead—this form of debt increased five-fold in the year to June, comprising, at one point, 17 percent of market capitalisation—the government poured more petrol on the flames, allowing individual investors to open as many as 20 stock trading accounts.

The result was a further spurt in share values. Confronting a massive financial bubble, the government initiated a crackdown on margin lending on June 13, setting in motion the present sell-off. The decision to rein in margin lending was premised on the assumption that, with its wide-ranging powers, the government could control the situation and gradually let air out of the bubble.

But the laws of the capitalist market have proven to be stronger than even the most powerful regime. The Chinese government now confronts a runaway plunge, threatening to destabilise the entire debt-ridden financial system. Local government authorities alone are estimated to have some $4 trillion in outstanding loans.

The meltdown has potentially explosive political consequences. Having lost all claim to stand for social equality, let alone represent socialism, the "red capitalists" of the Chinese Communist Party live in mortal fear of an eruption of social and political struggles by the Chinese working class.

Now, as the Chinese economy slows—GDP growth may fall below the official target of 7 percent, and possibly to as low as 4 percent—that prospect looms ever larger, even as the social constituency on which the CCP sought to base itself becomes increasingly hostile and the façade of the regime's "infallibility" is shattered.

The financial crisis in China will lead not only to a further slowdown in global economic growth, intensifying the struggles of the international working class, it will create the conditions for those struggles to be joined by one of its most powerful battalions.

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