Chinese leadership meets amid mounting economic problems

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Significant problems are confronting the Xi Jinping regime as the third plenum of the Central Committee of the Chinese Communist Party meets this week to discuss the direction of the economy.

The meeting, which began on Monday and concludes on Thursday, did not get off to a good start, with the release of data showing that growth had slowed in the second quarter compared to the first three months of the year.

China's GDP rose by 5.3 percent in the first quarter and economists had predicted it would increase by 5.1 percent in the second, but the figure came in at 4.7 percent.

A breakdown of the data underscores some of the key issues confronting the Chinese political leadership. Industrial production was up by 5.3 percent in June, beating expectations and reflecting the official policy to promote the development of "new productive forces" but retail sales rose by only 2 percent for the month, well short of predictions.

In a sign of deflationary pressures, consumer prices rose by only 0.2 percent in the year to June. In housing and real estate, which has been a mainstay of Chinese economic growth, the downward pressure was clearly evident.

New home prices fell by 4.5 percent in the year to June which, according to calculations by Reuters, was the largest decline in nine years. New construction starts were down by 23.7 percent in the first half of the year while property investment fell by 10.1 percent over the same period.

The latest data express deepgoing structural problems in the economy which now confront the government as it tries to change the course of policy under intense financial, economic and social pressures, both internally and externally.

In the wake of the global financial crisis of 2008, which had a major impact on the Chinese economy, leading to the loss of an estimated 23 million jobs, a massive housing and infrastructure program was initiated such that real estate and property development, and its related industries, accounted for as much 25-30 percent of the Chinese economy.

While stimulus was provided by the central government, this expansion was financed in the main by local government authorities, which borrowed large amounts of money through so-called local government financing vehicles (LGFVs).

The debt used to fund major infrastructure projects was financed through the sale of land for real estate and housing development.

The sharp slump in the property market, which began three years ago and has seen a host of companies go under—the most well-known of which was the collapse of the property giant Evergrande—meant that local governments and their LGFVs lost a major source of revenue.

A recent article in the *Wall Street Journal* highlighted the extent of the financing of LGFVs. It said economists had estimated the size of their debts at between $7 trillion and $11 trillion, about twice the size of central government debt.

"The total amount isn't known—likely not even to Beijing, say bankers and economists—because of the opaqueness surrounding the financial arrangements that allowed the debt to balloon," it said.

It is estimated that around $800 billion of the LGFV debt is classified at high risk of default.

The *Journal* article cited analysis by the Rhodium Group, a research firm, which "found that only a fifth of nearly 2,900 LGFVs it reviewed last year had enough cash to cover their short-term debt obligations and interest payments."

The prescription offered by economists, internationally and some within China, is that the government should initiate a stimulus package to boost consumption spending in order to maintain economic growth.

As Cornell University economics professor Eswar Prasad, a long-time analyst of the Chinese economy, noted in a recent comment piece in the *Financial Times*: "The government is resisting the clamour for monetary and fiscal stimulus, for fear of creating financial risks and adding to its debt burden."

Some measures had been taken by the government and the central banks but "getting households [mainly in the middle classes] to consume more, when their confidence is at a low ebb and they see their homes and stock market investments falling in value, has proven a tougher proposition," he wrote.

The main thrust of government policy is the development of what Xi has called "highly quality productive forces." The focus is on the manufacture of high-tech products, of which a major component is so-called green technology goods such as electric vehicles, solar panels and batteries as well as medical equipment.

China is already a world leader in many of these areas, both in regard to technical efficiency, since it is able to draw upon a vast pool of graduates from scientific institutions, and in terms of cost, because of innovations in production methods.

Here the perspective of the Xi regime has run into a major obstacle—the determination of the United States to crush Chinese economic development, which it regards as the greatest threat to its continued economic hegemony.

Starting under the Trump administration and continued and deepened under Biden, the US has imposed a series of sanctions and constrictions on the export of high-tech components as well as imposing tariffs on China's exports of electric vehicles and other green technology products, in which the European Union has joined.

The claim is made that so-called state subsidies are the reason for Chinese dominance in these areas and so its exports must be restricted on the grounds that they are "unfair competition" in global markets. Such claims are shot through with hypocrisy given the massive subsidies being provided to corporations by the Biden administration under the Inflation Reduction Act and the CHIPS Act.

For the Xi regime, the development of a new economic paradigm is an existential question. It sits atop a massive working class, estimated to be 400 million strong, and a vastly expanded urban population.

Having long ago abandoned any commitment to socialism, its sole basis of political legitimacy among the broad mass of the population is that it can continue to provide economic growth and an increase in living standards.

The turn to a new economic model and its impact on older industries, particularly construction, and the refusal of the government to lift spending on social welfare measures, which Xi has criticised in the past as a trap leading to "lazy people," is generating major social tensions.

Some of these were reported in a major article in the FT this week entitled "Can Xi keep a lid on social strains?"

It noted that across the country "multiple indicators of social stress are flashing red as weakness in parts of the economy takes its toll. Official and unofficial data show rises in everything from labour market stress and housing foreclosures to labour protests, suicides, crime and random violence."

Ever since the Tiananmen Square massacre of June 1989, it noted, the Chinese regime had suppressed social unrest while economic growth gave the regime so-called "performance legitimacy."

That is now being called into question. The downturn in property and construction is already having an impact with about 10 million workers leaving the construction industry in 2022 and 2023.

The article reported on a conference in China last year comprising delegates from municipalities and provinces which heard that perceptions about inequality "between rich and poor, cadres and the masses, have become general beliefs."

The China Labour Bulletin in Hong Kong, which provides a limited coverage of labour unrest, has reported that there were almost 1,800 "incidents" in China last year, more than double that of 2022 and exceeding levels before the pandemic, with the construction industry the major source, followed by manufacturing.

The article cited the results of a survey in social attitudes pointing to the shift from optimism to pessimism.

Survey results in 2004, 2009 and 2014 noted that most ordinary people were not "overly concerned" with income gaps, most were optimistic about their family prospects and many believed that upward mobility depended on merit.

The 2023 survey showed a marked change with respondents seeing "non-merit-based features of the social order, such as unequal opportunities, discrimination, and relying on connections, as relatively more important determinants of whether one is poor or rich."

The authors of the report said the results did not suggest that popular anger over inequality was "likely to explode in a social volcano of protest activity...

"They do suggest, however, that the performance legitimacy accumulated by the leadership through decades of sustained economic growth and improved living standards appears to be beginning to be undermined."

Minxin Pei, a professor of governance at a California college and the author of a book on the surveillance and social control methods of the Xi regime, told the FT these measures had worked so far in a relatively tranquil environment, but that could change and there will be "lot more incidents of instability or unrest."

He said if there was a prolonged period of low economic growth the CCP would enter uncharted waters with few precedents since Deng Xiaoping opened China up the market development at the end of the 1970s.

He did not elaborate but his remarks recall the crisis of 1989, which led to the Tiananmen Square massacre. The target of the regime extended far beyond the student protestors. The repression was above all directed against the working class in the industrial centres and was a central factor in the full restoration of capitalism in China and its integration into the global capitalist market.

The turn by Deng to the capitalist market begun in 1978 had enormous social consequences. Now the Xi regime is seeking to undertake a new turn, the results of which have the potential to be even more explosive because of the massive expansion of the Chinese working class over the past three decades.