League for the Fifth International
Fighting for the formation of a new world party of socialist revolution
Published on **League for the Fifth International** (https://fifthinternational.org)

Getting the measure of China

Wed, 26/03/2008 - 12:57

As the US economy moves into recession, Peter Main looks at the possible repercussions on China, a country that has become an icon of globalisation's dynamism in recent years. Rather than coming to the rescue of world capitalism, he argues that the coming year will see China face slackening export markets at a time when its domestic cycle is moving towards its peak.

The prospect of a recession in the USA has focused attention on the likely consequences for the rest of the world. As the world's biggest national economy, the US is often described as the "locomotive of the world economy" but nobody is in any doubt that, in recent years, this engine has been increasingly reliant on China for maintaining its speed. For years, the pundits of globalisation have pointed to the growing interdependence of the US and Chinese economies as a win-win proof of capitalism's efficiency and dynamism. It was taken as tangible evidence that global capitalism could spread social and economic benefits to the south and east. Put briefly, cheap labour in China supplied cheap consumer goods to the US. This, together with Chinese purchases of US Treasury bonds, contributed to a powerful deflationary pressure that allowed interest rates in the US to be kept low. Cheap credit encouraged expenditure that, in turn, kept the US economy growing. Internationally, China's booming industrial economy created demand for energy, raw materials and food. Thus, China has become an icon in recent years of global capitalism's dynamism and its capacity to spread.

Leaving aside for a moment the bourgeois ideological aspects of this outline, the economic analysis as a whole is in itself problematic. It is accurate as description of the dynamics of the industrial cycle that began in China at the turn of the century and in the US in 2001, but becomes erroneous in its assumption that this apparently virtuous spiral could maintain its stability and momentum indefinitely - or, at least as long as China's countryside was a reservoir of cheap labour. Now that the credit crunch has brought growth rates in the US juddering to a halt, attention is turning to whether China is now a big enough economy to pull along the rest of the world, even without constantly expanding exports to the US. Those that believe this is now possible argue that China has "decoupled" from the US and can power ahead on the basis, primarily, of its domestic development.

This argument cannot be dismissed out of hand. Although production for the export market has undoubtedly been an important factor in China's economic development, it has never been dominant. After, accession to the World Trade Organisation and the resulting boom, it accounts for some 40 per cent of GDP, and, in recent years, growth in domestic demand has contributed more to GDP growth.1 Moreover, the US is no longer the number one destination for China's exports, accounting for 21 per cent as against the EU's 23 per cent. With a population of 1.35 billion, more than 100 cities with populations of more than 500,000, a working class of perhaps 350 million and annual investment in fixed assets, broadly speaking infrastructure and production facilities, equivalent to more than 45 per cent of GDP2, it is clear that a decline in US imports would by no means automatically result in the wheels of Chinese industry grinding to a halt.

Nonetheless, this should not be taken to mean that a US recession would have no impact on China at all. Certainly, the dramatic falls on stock markets in Shanghai, Shenzhen and Hong Kong, when it became clear in mid-January that major financial institutions such as Merrill Lynch were now convinced not only that the US faced a recession but was already in one, suggest that the main players in those markets are fearful of the consequences. Internationally, the World Bank has calculated that China's GDP growth could be reduced by up 0.5 per cent for every 1 per cent reduction in US consumer spending.3 That may not seem too significant against a background of 11.4 per cent GDP growth in the last year but it would mean that a drop of 10 per cent in US consumer spending would mean virtually halving China's recent growth rates - a sizeable shock to any economy.

Moreover, trade in consumer goods is by no means the full extent of China's engagement with the world market. In recent years, capital goods have become an increasingly important component of exports and so a downturn in industrial investment in the US would increase the impact on China's production. In addition, China's own financial institutions are not immune to the effects of the sub-prime crisis because of their own investments in the US. Equally, a recession in the US could be expected to have some impact on the EU economy and a consequent reduction in China's exports in that direction. Lastly, it should not be forgotten that China's export trade is supported by an import trade that is almost as big and draws in raw materials, semi-finished goods, energy and food from around the world. Any contraction in China's exports, therefore, would have an immediate impact on many other countries' economies.

On balance, then, the evidence does not support the "decoupling thesis" if that is understood to mean that a US recession would have, at most, only a marginal effect on China's continued economic growth. That, however, does not exhaust the question of the prospects for China in the short to mid term and ignores the dynamics of China's "domestic" economy. Even if the downturn in the export trade does knock several percentage points off GDP growth, could that be offset by continued expansion of the domestic market? Could that be enough to allow China to take over as the world's economic locomotive?

Just the fact that such a question can now be posed shows the transformation that has certainly taken place in China in the last three decades. Given that last year the International Monetary Fund estimated that total Chinese GDP, calculated on the basis of purchasing power parity(PPP), was the equivalent of $11.6 trillion while the US economy was $13.5 trillion, it might not seem unreasonable to suggest that China was on the brink of overtaking the US anyway, even without a recession. Such an argument, however, is an exaggeration, and one that serves the ideological interests of the supporters of globalisation.

If we leave aside the inherent limitations of GDP as a measure of the productive capacity of the economy4 then a case can be made for using PPP in order to compare the GDP's of countries which have very different levels of development. Obviously, the effect of using purchasing power parities depends on the multiplier used to convert the GDP figure from one based on exchange rates. With regard to China, the most widely used converter, and the one used by the IMF in the calculation referred to above, has been the one applied by the World Bank: a ratio of 4.5 times the GDP estimated at market exchange rates. However, in December, 2007, on the basis of the International Comparison Project's (ICP) more rigorous calculation of prices and incomes in China, the World Bank reduced this multiplier by almost 50 per cent to 2.3 and on this basis China's GDP for 2005, which was $2.2438 trillion at the official exchange rate, was recalculated as $5.3332 trillion, rather than the $8.88 trillion previously estimated.

Using the new multiplier, the estimated figures for 2007 are $7.04 trillion, rather than $11.6 trillion, not much more than 50 per cent the size of the US economy which, in the same series, is some $13.5 trillion. In global terms, China is now reckoned to represent 9.7 per cent of world GDP, rather than 14.5 per cent.5 However, because such a large proportion of China's economy is geared to exports, which are obviously traded at world market prices, even this calculation is still likely to over-estimate the size of the economy. In fact, the World Bank's previous multiplier had long been put in question by research carried out in 1999 by China's official statistics office and the OECD. This suggested a multiplier of approximately 2, very similar to the ICP's final figure of 2.3.6 At the time, however, most Western economists, both academic and official, were keen to talk up the size of the Chinese economy. Even now, it should be borne in mind that the GDP figure itself is still based on Chinese government statistics rather than on the sampling and survey techniques more generally used elsewhere.

Clearly, this much reduced estimation of the comparative size of the Chinese economy immediately undermines the idea that it is close to overtaking the US in overall size or that it could play the same "locomotive" role within the global economy. The purchasing power parity figures were also used in the calculation of one of the most famous statistics used to show how beneficial capitalist restoration in China has been - the raising of 200 million peasants out of poverty. The figure itself is calculated on the basis of Chinese government statistics that show that in 1978 250 million people lived below "the poverty line" but by 2003 this had been reduced to 29 million. The "poverty line" was defined as the equivalent of 67 US cents, using the World Bank's 4.5 multiplier of actual income in yuan.7

There are two points to be made about this; in 1978, poverty and hunger were widespread in China, indeed, it was that poverty that provided the impetus for the peasants of Anhui province to break out of the commune system and re-establish family farming in 1977. This immediately led to an increase in output and was probably the major influence on Deng Xiaoping when he introduced "reforms" of agriculture the following year. Nonetheless, it is difficult to see how a criterion of poverty based on money income can be applied retrospectively to a population for whom money transactions were not the norm. Certainly, the money income of peasants at that time was extremely low but they did not have to pay for a lot of things that are now commodities.

Secondly, and more importantly, the Chinese government's definition of poverty differs from the widely used UN and World Bank definition, which is a dollar a day. Using the new PPP multiplier and this criterion produces the staggering total of 300 million Chinese living, or at least surviving, below this "international poverty line", that is to say, in absolute poverty. According to the World Bank, this would be an over-estimation because the poor are concentrated in the countryside where lower prices prevail and in their first commentary on the new figures they estimate that, in 2004, the figure would have been approximately 15 per cent of the population, accounting for some 195 million people.8

The development of Chinese capitalism has not only been a major source of material benefit for the imperialist powers but also an ideological one. Characteristically, restoration is presented as having ensured decades of "steady growth" - the 2005 OECD report on China, for example, spoke of "9.5 per cent per year for the last 20 years"9. Explicitly or not, this growth in the Chinese economy is compared to a country which "communism" had reduced to abject poverty and rendered an international pariah. Certainly, there is no question that there has been enormous economic development in China and integration into the world market has been an important contributor to that growth - proof, if more were needed, of the complete bankruptcy of the strategy of building "socialism in one country". Nonetheless, in order to obtain a clearer understanding of the content of that growth and its social and political consequences, it is necessary to get beneath the ideological form in which it is customarily presented. The fact that we have no alternative data cannot be wished away but makes it all the more important to bear in mind both their institutional and their ideological origins.

With regard to understanding growth rates in China, expressed as percentage GDP growth, it is particularly important to remember this for two related reasons. Firstly, the starting point for such statistical series, China before the reforms of 1978, cannot itself be measured in such terms, comparable figures just do not exist, even though economists have tried to compute equivalents. It follows that, especially for the early years of the "reform" period, the calculation of growth as a percentage of the previous "size" of the economy will be unreliable. Secondly, even without any actual development, GDP figures would increase over the period because the restoration of capitalism has meant that whole parts of the economy, which were previously either allocated according to bureaucratic planning or simply did not exist, have now been "marketised" and so have to be paid for. Thus, in 1978, before the "reforms", basic health services were provided free to members of communes in the countryside while in the cities the "iron rice bowl" guaranteed housing, health, social services and education, albeit at an equally basic level, to the population. Today, all health services are cash-based and all urban housing was privatised between 1995 and 1998. In addition, to the impact on GDP of including these factors, we also have to reckon with the resulting explosion of accountants, lawyers and estate agents whose activities also add to GDP.

A further consideration is that China's estimated population of 1.35 billion is believed to grow at the rate of 1.07 per cent per year10 and just to cater for this steady increase in population it has been calculated that GDP has to grow by 6.5 per cent per year. In rough and ready terms, therefore, growth in GDP per capita has to be calculated by subtracting that figure from the "headline" figures. With regard to those headline figures, the most common figure is that quoted in the OECD survey, 9.5 per cent annual growth. Such figures give the impression of steady expansion but this is highly misleading; in 1984, according to official statistics, GDP growth approached 15 per cent while in 1989 and 1990 it was below 4 per cent. Two years later it was back up above 14 per cent before declining steadily to a little below 8 per cent in 1999.11 In other words, as Figure 1 shows in graphical form, the Chinese economy exhibits quite marked variations in growth rate and the restoration of capitalism has by no means ushered in a period of steady and balanced development. On the contrary, we can now expect China to be subject to the industrial cycle of booms and slumps that are characteristic of all capitalist economies.

Above and beyond those considerations, we also have to question the validity of the figures themselves. In other countries, formally independent institutions calculate the statistics using sampling and survey techniques. In China, however, figures are still compiled by the ministries responsible for different sectors, a system inherited from the degenerate workers' state. Jonathan Story quotes the Asian Development Bank as routinely deducting two points from China's official growth rates.13 In a symposium organised by China Economic Review in December 2001, Thomas Rawski presented a range of contradictory data culled from Chinese statistics for the years 1997 and 1998 to illustrate their unreliability and the "intentional falsification of economic performance indicators".14 One set of figures illustrates the point, particularly if one remembers that these were the years of the East Asia crash when it was extremely important to China to maintain the appearance of economic stability and continued progress. Between 1997 and 2000, GDP reportedly grew by 24.7 per cent, yet energy consumption, which normally moves roughly in parallel with GDP, declined by 12.8 per cent.

The manifest unreliability of China's official statistics is a serious problem for international capital. Potential investors need to know, at least within their own terms, what is actually happening and, as China has opened up, it has become increasingly possible for researchers to compile their own statistical series. One example of this is the Goldman Sachs "China Activity" (GSCA) series upon which figure 2 is based. Interestingly, a comparison between this series and the official figures for growth in the late 1990s, 4 - 5 per cent for GSCA, 8 per cent officially, suggests that the Asian Development Bank was overoptimistic as to just how serious the situation then was. Equally, the GSCA figures for 2006 point to higher growth rates than the official account, at a time when Beijing was increasingly concerned that the economy was over-heating.

Indeed, for several years, slowing down the rate of growth of the economy has been a major priority for Beijing. Uncontrolled growth threatens to bring in its wake not only inflation and a worsening of the imbalance between the coastal provinces and the interior but also protectionist measures in China's main trade partners, especially in the US presidential election year. As a result, since 2005 the yuan, which was previously effectively tied to the dollar, has been allowed to appreciate by some 12 per cent. In addition, at the end of 2007, various incentives to the export trade, such as tax breaks, were removed and some restrictions were introduced, for example, on goods whose production requires high energy consumption. Internally, in an attempt to curb bank lending, the ratio of bank reserves to lending has been raised.

Despite such measures, however, the trade surplus in 2007 grew by 47.7 per cent to $262.2 billion while GDP growth for the year is estimated at 11.2 per cent. 16 As a result, foreign exchange reserves, which were already the largest in the world, rose still further to $1.53 trillion. This enormous pool of capital is itself a source of instability since. To the extent that it is released, or "leaks", into the domestic economy, it fuels inflation. Equally, spending a significant proportion of it internationally would contribute to the falling value of the dollar and, thereby, devalue both the remaining reserves and China's dollar-denominated investments abroad.

Eight years into the current cycle, however, there are signs that it is reaching its peak. An annualised growth rate of 11.4 per cent for 2007 is higher than the 11.1 per cent of 2006 but masks a decline from 11.9 per cent in the second quarter to 11.2 per cent in the fourth. 17 Growth has forced up the price of imported raw materials, oil and food and these, together with increased urban demand for domestically produced food, have led to an official inflation rate of 6.5 per cent.18 This is the highest figure for a decade, and it minimises the impact on the working class cost of living in which food prices, some of which have risen by as much as 50 per cent, play a very large role.

In early January, in an attempt to bring this potential source of social unrest under control, the government imposed price controls on a range of necessities including food and fuel but, while these measures may steady prices in the shops, the costs will either have to be met by producers, including China's hard-pressed farmers, or by government subsidy. The first of these would depress domestic demand even further at a time when there is an urgent need to stimulate it in order to re-balance the economy, while the second would both add to inflation and drain away state resources when they will also be needed for investment in the interior.

The rapid rise in prices on the Shanghai and Shenzhen stock exchanges, which have seen 400 per cent19 increases in less than two years, may in part be driven by inexperienced, small-scale investors but the prospect of easy profits which attracted them suggests that the rates of return on investment in productive capacity are on the wane. Certainly, the dramatic volatility seen throughout 2007 is a characteristic indicator of the nervousness in the markets usually seen as the cycle reaches its peak. As a result of both international and domestic pressures, then, the prospect for the coming year is one of increasing economic instability. As we have seen, the growth rate slowed in the final quarter and this can be traced to a decline in exports; the surplus on trade in December fell 14.2 per cent20 from November's figure. While one month's figures cannot prove a downward trend, the impact of an unexpectedly cold and snowy winter in Central China will bring the figures down further - early projections suggest the first two weeks of blizzards have cost 54 billion yuan in lost production, infrastructure damage and agricultural losses.

In the year of the Beijing Olympics, there cannot be any doubt that the government will make full use of its still extensive controls to try avoid any social unrest - as the imposition of price controls has already shown. However, it may prove no better prepared to deal with any major cuts in production and employment in the export-processing industries than it was to deal with weeks of blizzards. The sector is heavily dominated by companies based in Taiwan, South Korea and Japan and even those based in Hong Kong can be expected to put their profits before their patriotism - if sales fall they will lay off workers and close plants. In China as a whole, the number of privately owned firms has been growing fast, in 2006 by 15 per cent, and at the beginning of 2007 they employed almost 64 million workers 21 and produced some 65 per cent of GDP. After such rapid growth, any downturn can be expected to prompt a rash of closures.

The coming year, then, rather than seeing China take up the strain of dynamising the world economy as the US enters recession, is more likely to see the country grappling with the combined effects of a slowdown in the world economy just as the domestic economy moves towards the peak of its own cycle. We live in interesting times.

For a detailed exposition of the restoration of capitalism in China, see Main, P., 'From Mao to the Market', Fifth International, vol. 2, no. 4, autumn 2007. Available from shop.fifthinternational.org

ENDNOTES

1 The Economist, 24 October, 2007

2 ibid

3 Figures from World Bank Quarterly Update, Beijing November 2008, p.6

4 Bourgeois economics regards a national economy as essentially an exchange mechanism, a market upon which goods and services are traded, not a system of production of values. Consequently, the "size" of an economy is measured by totalling up the prices of all end goods and services, giving appropriate "weightings" to different sectors.

5 Figures from 2005 International Comparison Program Preliminary Results, 17 December 2007, World Bank

6 See OECD Economic Surveys: China, Paris 2005, p.71

7 ibid

8 Figures derived from China Quarterly Update, World Bank, Beijing, February 2008, p 22

9 OECD Economic Surveys: China, Paris, 2005 p. 12

10 Official census figures for 2000

11 Figures from CEIC, quoted by Lo, Phantom of the China Economic Threat, Basingstoke 2006, p.11

12 Figures derived from B Naughton, The Chinese Economy, Cambridge, MA 2007, p.144

13 J.Story, China, the race to the market, Edinburgh, 2003 p.62

14 Thomas Rawski, What's happening to China's GDP Statistics? prepared for China Economic Review 12, December 2001, p.3

15 See Goldman Sachs Global Economics Paper 147, October 2006

16 Figures from General Administration of Customs, quoted in Asian Times Online, Jan 15, 2008

17 See China Quarterly Update, World Bank, Beijing, February 2008, p 2

18 ibid, p.4

19 According to The Economist, 24 October 2007

20 Asian Times Online, op cit

21 Figures from Speaking Out, China Labour Bulletin Research Report 5 www.clb.org.hk [1] Dec 2007, p5

Links:
[1] http://www.clb.org.hk