China Cannot Save the World from Crisis

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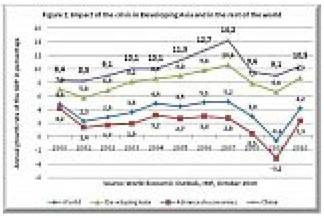
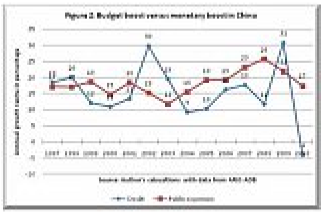
While North America and Europe were hard hit, China has resisted the international crisis of 2008 thanks to a rescue plan which combined huge public spending, a low interest rate and consumption subsidies. China's growth rate reached 9% in 2009 and 10.4% in 2010, dragging in its wake Asia and Latin America out of the crisis. It has also managed to maintain unemployment to a sustainable level. China even overtook Japan, in 2010, as the second largest economy in the world in terms of GDP and it is closing the gap with the US. On the whole, China's rise seems unaffected by the subprime crisis. A closer look shows that real problems lie ahead. Chinese workers don't accept overexploitation any longer. A wave of strikes spread during the summer of 2010. Workers were fighting for wage increases, improvement of working conditions and the right to organize and bargain. Inflation, especially of food products, which accelerated since the middle of 2010, is adding a new problem for workers and a concern for the government which fears a wave of discontent. On top of that, the government is doing its best to prevent any contagion from the democratic revolutions in Arabic countries. Although the overall situation in China is completely different, these democratic revolutions show to Chinese workers that it is indeed possible to topple even the worst and most powerful dictatorships.

China's resistance to the first stage of the recession

The impact of the crisis on China and Asia, so far, has been limited (Sanuk, 2008). Asian banks were not much engaged in subprime loans and toxic products, unlike European banks. With the exception of South Korea, Asian countries did not rely on short-term capital and bank loans to finance their economies. They were not caught in a debt trap like Eastern European countries or Greece. Most of them, in particular China, had accumulated huge amount of currency reserves and were able to cope with capital flights that occurred at the end of 2008. Asian countries were primarily hit by the fall of their exports because of the slump in demand in North America and Europe. As a general rule, the recessive impact has been stronger in the most open Asian countries whose exports were concentrated in manufacturing and where the USA was an important customer. For instance, exports of manufactured products represent around 70% in Malaysia, more than 40% in Thailand and Cambodia, around 30% in China, South Korea, the Philippines and Vietnam, but less than 10% in India and Pakistan. These characteristics explain why the three biggest and most populated countries in Asia, China, India and Indonesia have not experienced a single quarter of recession between 2008 and 2009. The resilience of these three countries and most of all, China, which is among the biggest trade partners of Asian countries, led to a quick rebound in the second quarter of 2009 and a much stronger "V" shape recovery than in the rest of the world.



Firstly, to absorb the shock of the fall of exports, Asian countries have launched unprecedented rescue plans in the region, unlike during the “Asian crisis” of 1997-1999 when IMF sponsored structural adjustment plans worsened the crisis. The Chinese rescue plan draws the attention by its magnitude: US$ 585 billion amounting to 13.3% of GDP to be spent on a two-year span. On average, the rescue plans announced by Asian countries amounted to 7.5% of GDP against 2.8% of GDP for the G7 countries. Moreover, Asian rescue plans were more focused on public expenditure than tax cuts. On average, Asian countries dedicated 80% to increases in public spending compared with a 60% average in G20 countries. The only exception is Indonesia where tax cuts dominate. Those public expenses were accompanied by expansionary monetary policy. The median interest rate of Asian central banks has decreased by 2.25 points which is five times more than during the previous crisis. As the banking system continued to work, this had a positive impact on growth. In countries like Vietnam and China the expansionary monetary policy played a dominant role. In China, public spending has increased by a modest 26% in 2008 up from 23% in 2007, but it came back to 21% in 2009 and even 17% in 2010 when the rescue plan officially ended. On the whole, public expenses did not play a crucial role to absorb the shock. It is in fact the expansion of credit which took the lead in 2009 with a spectacular increase of 31% (see figure 2). It too fell in 2010 to -4% when the Chinese government decided to cool down the economy to prevent easy money inducing a new speculative bubble (more on this point below).



Second, household consumption remained steady as employment did not collapse during the crisis. In times of crisis, there are usually no strong increases in the unemployment rate in Asian countries, for there are no unemployment benefits except in a few countries. Workers who lost their jobs in industry try to find one in services or work as self-workers or return to the family farm whenever it is possible and when there is still one. It is especially the case in China where hundreds of thousands migrant workers went back to the interior in the winter of 2008 or stayed there after the end of the new year in February 2009. But because the economy recovered in spring 2009, a lot of them returned to the cities to find an urban job, which pays more. Thirdly, defying many sombre prognostics, Chinese exports fell from September 2008 to February 2009 but did not collapse and soon recuperated thanks to recovery in world trade. Given the high import content component of Chinese exports (about 50%) imports fell in the same proportion so that the current account stayed almost always positive although by a smaller magnitude (see figure 3). This reveals both the resilience of China to external shocks and its weakness at the same time.

The myth of Asia decoupling from the rest of the world

China's fast trade success is due to its role as an assembly centre of components made elsewhere in Asia, mostly in Japan and South Korea and to a lesser extent in South-East Asia. The final products assembled in China are in the main destined for the rest of the world, particularly Europe and North America. To be less vulnerable to the crisis stemming from the USA and Europe, East and South-East Asia need to absorb a major and growing part of its production of final products. Although East Asian internal trade has progressed since the crisis, it has not yet reached a stage where it could cushion worldwide trade contraction. Although China has become the second economy of the world, bypassing Japan in 2010 and catching-up with the USA in terms of the absolute value of its GDP, China and the rest of Asia are still far from supplanting the USA which has the biggest markets in the world. If we take into account total Chinese population, income per capita would catch-up with the US in 25 to 50 years time, based on current assumptions. If we now only take into account the richest regions of China, most of them being located on the coast, representing 42% of the Chinese population in 2005, this catch-up could occur in just 10 to 20 years. The most optimistic hypothesis made by the Asian Development Bank shows that at the present pace, the 22 Asian countries which are classified as 'developing Asia', should outstrip the OECD countries' consumption by 2030. All these predictions rest on optimistic scenarios and are far from certain given the present international crisis. To be able to decouple from the rest of the world (at least relatively, because there is no such thing as a completely autonomous region in the present global economy) Asia, and most of all China, must rebalance its economy away from export-led growth and in favour of the domestic market. This can only be achieved if three conditions are fulfilled. Firstly, China must revalue in part its exchange rate to lower the price of imports and hence the cost of goods it produces for the internal market and make exports less profitable than they are. Secondly, and most importantly, China must significantly raise the real wages of urban and rural workers so that internal consumption can recover from its present extremely low level (35% of GDP). This is the most sensitive decision because Chinese capitalists and bureaucrats are used to living like fat-cats thanks to the huge profits that state-owned and private enterprises are making on the back of overexploited workers. Thirdly, China must increase the interest rate from its present low level in order to discourage the very high investment in capital intensive industry and reorient the economy in favour of domestic services like education, health, housing, culture and leisure which are needed by the vast majority of Chinese people. These are labour intensive and could generate the millions of jobs that China requires, and they are less energy consuming and less polluting than industry. China has made some progress in this direction but is far from the objective.

Can China resist a new recession?

In 2011, the international crisis entered a second stage. The crisis in Europe is very serious and the USA is not in a much better situation. A second recession is coming and there will be a new slump in world trade. Chinese and Asian exports will be hit again and the question is whether China and Asia will be able to resist the new trade contraction with a massive rescue plan again? There are reasons to be pessimistic. China and the Asian countries cannot launch massive public expenditure or massively expand credit every two years. The last rescue plans have already created problems that are not yet resolved: in the Chinese case, a sharp increase of non-performing loans in the banking sector, inflation and speculative bubbles in real estate and in the stock exchange. Like in the USA and Europe, Chinese banks will have to be rescued with public money. And like in the USA and Europe, it is always to the workers that governments present the bill. In China, rescuing the banks and local authorities which are heavily indebted would cost a lot of money and if workers have to pay for it in one way or another, the objective of rebalancing growth in favour of domestic demand would be postponed to the long-term and with it the myth that China could drag the world out the crisis.

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