

China's spectacular stock market crash: Anatomy of a Collapse

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The Chinese state's intervention after the stock market crash was immensely political — as was the collapse itself.

The sheer enormity of the destruction was staggering. In less than a month, from mid-June to early July, the Shanghai Composite Index plunged by 30%, wiping out more than \$3 trillion in share value from its June 12 peak. The wealth liquidated in the crash was equivalent to approximately 30% of China's GDP (\$10 trillion in 2014), 20% of the United States's GDP (\$17 trillion), and about ten times the size of Greece's current total debt (\$350 billion).

The collapse sent shockwaves around the world, not surprising given that China accounts for more than one-third of global growth [1]. China's spectacular stock market crash is a testimony to the increasing volatility and the underlying contradictions of the Chinese economy. More importantly, rather than simply being a financial crash, it is also immensely political.

No one can claim they didn't see it coming — the only uncertainty was the exact timing of the crash. Since last year, there's been a 150% rally fueled by [margin trading](#) (the practice of using borrowed money to buy stocks). The overvaluation of shares was widely recognized, with some analysts estimating by more than 20 percent [2]. The mainstream financial press had been describing it as a bubble for months. Even the Chinese government, which had encouraged people to invest, issued warnings back in April, and tried to tighten trading rules to dampen the exuberance.

The crash finally came this month, producing widespread panic and pushing the Chinese government to implement a range of stopgaps.

It halted all new stock listings, restricted short-selling (the practice of betting against price falls), and ordered some of the largest state-owned enterprises — and even the state pension funds - not to sell shares [3]. Instead, the Chinese state quickly made plans to buy more shares, while the country's top twenty-one securities brokerages collectively pledged to purchase shares worth at least \$19 billion [4]. The Chinese government also directed the central bank to lend money to brokerages and investors to buy shares totaling \$365 billion.

It was this highly political intervention into the stock market — popularly dubbed *jiushi*, or “rescuing the market” — that came as a surprise to many, both within China and abroad. And what made it even more political was the thought of what the spectacle of tens of millions of individual investors — ordinary people investing their incomes, loans, and savings — suddenly losing their money might do to the legitimacy of the Communist Party.

The Chinese Economy and Its Discontents

Stock market crashes are a relatively new phenomena in China — during Mao's reign (1949-1976), stock exchanges were regarded as a capitalist institution and thus abolished. They weren't reintroduced until 1991, well into the post-Mao reform period.

In these early years, however, buying shares was considered too risky; instead, investors and ordinary people preferred to purchase government-issued bonds or put their money in state-owned banks for safe returns. Incomes for the majority of the population were also quite low, so few people could afford to invest in the stock market. While volatility and risk certainly existed, stock market crashes were not a part of the economy.

This started to change in the 2000s as China's economic growth, facilitated by financial liberalization and the commercialization of the banking system, channeled money into the stock market and fueled a huge bubble. Between October 2005 and October 2007, the Shanghai Composite Index grew from a little over 1,000 points to almost 6,000 points — only to plummet to less than 2,000 points with the onset of the global economic recession.

The effects on Chinese industry were even worse. In the first six months of 2008, with the export sector shrinking due to declining demand in the North American and European markets, 67,000 factories closed across China. In the final quarter of 2008, an additional 50,000 factories were shut down. An estimated 20-30 million rural migrant workers temporarily lost their jobs in the process [5], and labor protests spiked. Many returned to their rural hometowns.

Intent on instantly propping up the country's falling growth rate, the Chinese government rolled out a \$586 billion stimulus package that focused on infrastructure instead of social services and welfare. It largely worked. The stimulus, and government intervention more broadly, was credited with successfully staving off a deeper recession. With mass unemployment and social unrest still a threat, it has committed to keeping its foot on the pedal and boosting the annual rate of economic growth above 8%.

Despite the government's concerted intervention, China's GDP growth rate has continued to decline: a mind-boggling 14% in 2007, it dipped to less than 10% for a few years, and then dropped to 7.4% last year — quite good by international standards, but low for China. This year, GDP growth is likely to be 7% or less, causing concerns about a further slide.

The government has made a virtue out of the slowdown, describing the Chinese economy as entering a period of "New Normal" in which growth is purportedly more balanced and sustainable. But there are lingering economic contradictions that are related to the recent stock market crash.

The housing market, built on the back of rapid urbanization, invited speculation that inflated housing prices. The rapid uptick prompted the government to depress housing prices in an attempt to prevent the bubble from bursting and triggering a wider crisis. This deflationary tactic rendered investment in housing and manufacturing industries less profitable, sending investors looking for high returns (often on borrowed money) to the stock market.

At the same time, the post-crisis stimulus package was being financed mainly through bank lending rather than direct state grants, and was made possible by loose monetary policy. The stimulus ended up exacerbating the existing local government debt problem, which the Chinese government was still working to address via a debt-for-bond swap program shortly before the stock market crash.

Finally, while fixed investment has contributed significantly to China's growth, consumption levels

remain low as a percentage of GDP. A sharper increase in domestic spending is necessary for the transition from an investment and export-led economy to a consumption-driven one, but this is a political issue more than an economic one. Low levels of consumption reflect the increasing share of incomes going to capital instead of labor in the post-Mao era, where workers have lost employment security and labor rights, and face enormous difficulty organizing independently and engaging in collective bargaining.

The expansionary monetary and fiscal policies the government has implemented since the financial crisis have largely failed to resolve these problems, and the recent crash has only made the situation worse.

The Shape of the Stock Market

Financial liberalization and government encouragement have made it extremely easy and appealing for individuals to trade in the stock market. Since mid-2014, more than 40 million new accounts have been set up, and a significant majority are individual investors.

Share trading, unsurprisingly, is concentrated in China's major cities and the wealthy east coast. But many also trade in second- and third-tier cities and towns, and the spectrum of who trades has broadened considerably.

One group that has entered the market in large numbers over the past year is younger people, primarily those in their twenties and thirties. These are mostly professionals workers making middle-level incomes, and migrant workers making lower- to middle-level incomes. This demographic's slow wage growth has encouraged it to put money in the stock market in the face of China's high urban living costs, exacerbated by the recent housing bubble.

Then there are slightly older people, the mom-and-pop investors in their fifties and sixties who have invested part of their retirement savings in the hopes of then contributing to their children's housing down payment.

Faced with low interest rates that dissuade them from putting their money in the banks, increasing social inequality, and few other ways to earn higher incomes, more and more people are willing to gamble their savings on the stock market, believing the government will not let the market crash. So while much of the Chinese media has focused on the fact that a plurality of the individual investors has only a high-school diploma — cynically implying that investors' lack of education caused the bubble — it's China's new middle class that is heavily involved in the stock market, acting rationally in an irrational system.

On its own, the stock market crash doesn't pose a real threat to the survival of the Chinese Communist Party, but popular discontent is growing, with large protests that include an increasingly assertive working class.

Politically, many people in China hold contradictory opinions about the role of the government. They believe, for instance, that the state meddles in and manipulates the stock market to the detriment of the investors. But when the stock market collapses, they hope the government comes to the rescue. Thus, both the failure of the state to control the stock market and what some deem excessive intervention damage its credibility and undermine its legitimacy.

This is a politically sensitive period in China; since its accession in 2013, the new leadership has sought to consolidate its power and regain legitimacy. It has launched an expansive anti-corruption campaign, disciplining more than 100,000 cadres across bureaucracies and levels of government, and simultaneously tightened censorship and cracked down on civil society activism. During the

stock market crash, the authorities detained and questioned more than 100 lawyers and NGO workers.

Since the 1990s, China's middle class has reluctantly offered support to the regime in exchange for a rising standard of living at the expense of liberty and democracy. How the government responds to the crash in the coming months may test this loyalty.

While the threat to the Chinese economy is real, there is a risk of overstating the impact of the crash. Even at its lowest point the shares level in the Shanghai Composite Index merely returned to that of March, still 80% higher than a year ago.

Moreover, the stock market plays a fairly minor role in the Chinese economy relative to other developed economies. The amount available for trading is only about a third of Chinese GDP compared to more than 100% for developed economies.

The number of participants is also comparatively low. The recent China Household Finance Survey found that only 9% of households actively traded shares and another 4% of households owned mutual funds. And less than 15% of household financial assets are invested in the stock market. This is still a large number given the size of the Chinese population, but it remains a small percentage for now.

In response to government intervention to restore confidence, two days after the market hit a low of 3,500 points, the Shanghai Composite Index surged by 10.6%, the biggest two-day gain since 2008. Fears were eased as the Shanghai Composite Index returned to 4,000 points.

However, despite the rebound, the ability of the state to continually inject money and confidence into the stock market is uncertain, and its decision to reflate the economic bubble may very well increase the size of the problem.

On Monday, the Shanghai Composite Index suffered an 8% plunge, raising fears of a repeat of the downward spiral of early this month. And if another, bigger crash occurs, it may have a significantly greater ripple effect on China's real economy.

A Left Response

The crash rekindled the age-old debate about the role of the state in markets, and the government response is being seen as a setback for free-market advocates both inside and outside of China. We will likely hear strong calls for greater financial liberalization and a larger role for the market in the Chinese economy. Indeed, there are already criticisms of government intervention and reports of global capital's displeasure.

The Communist Party is not opposed to more marketization. It has made clear its receptivity to more market-oriented reforms, including financial liberalization, and its willingness to encourage more market competition, private businesses, and individual consumption. However, it has not been able to implement significant reforms due to opposition within the government and state-owned industry. The current anti-corruption campaign is seen as clearing the way for the reforms.

The Left has to resist such deepening marketization, which will only lead to more economic instability and widening inequality. However, our knee-jerk response should also not be to defend Chinese state intervention in the economy as such. The Chinese government is responsible for creating a financial environment where individual investors are lured into gambling their incomes and savings, and its recent actions will likely inflate the bubble further.

Instead, we need to demand more regulation of the financial sector, as well as more equitable distribution of incomes so people won't depend on risky investment strategies to compensate for low wages and high living costs.

Because of the highly restricted political space in which they operate, China's social movements — including the restive labor movement, the environmental movement, and the feminist and anti-discrimination movements — often fly under the radar. But they remain China's only hope for a more socially just and environmentally sustainable society. When the next crash comes, the ability to chart alternative responses rests on their organizational capacity.

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P.S.

* "Anatomy of a Collapse". Jacobin. 7.30.15:

<https://www.jacobinmag.com/2015/07/china-market-collapse-communist-party/>

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Footnotes

[1] <http://www.economist.com/news/economic-and-financial-indicators/21586611-world-gdp>

[2] <http://www.bloomberg.com/news/articles/2015-05-29/credit-suisse-says-chinese-stocks-are-overvalued-by-more-than-20-percent>

[3] <http://www.afr.com/news/world/asia/china-159-billion-state-pension-fund-told-dont-sell-caijing-report-20150706-gi68hu>

[4] <http://www.cnbc.com/2015/07/04/china-brokerages-pledge-to-buy-at-least-193b-in-shares-to-stabilise-market.html>

[5] [http://finance.yahoo.com/echarts?s=000001.SS+Interactive#{"range":"10y","allowChartStacking":true}](http://finance.yahoo.com/echarts?s=000001.SS+Interactive#{)