CHINESE CRACKERS

> … if production were carried on according to the textbooks, crises would never occur.
> [The economists] prove that there would be no crises if the contradictions which they have erased in their imagination, did not exist in fact.
> … whenever a crisis occurred, all later economists declared that the *most obvious cause* of the particular crisis was the only possible cause of all crises.
> Karl Marx, *Theories of Surplus-Value*.[1]
>
> Business is always thoroughly sound and the campaign in full swing, until suddenly the debacle takes place.
> Karl Marx, *Capital*.[2]

Wikileaks revealed that, as prime minister, Kevin Rudd accepted the use of force against the Peoples Republic of China at the same time as he spoke about the Australian economy's riding high for thirty years on the back of China's industrialisation and urbanisation. The possibility that there are cables casting doubt on this prophecy seems slight. The closest local bureaucrats come to recognising that the future of the Chinese economy might be imperiled by its successes has been to parrot US calls to revalue the Yuan/renminbi (RMB). For the Chinese, the dragons in the path are excess liquidity and inflation fueling property bubbles. The 2010 China Update from the Australian National University gave two of its 330 pages to that 'liquidity tango' but neglected inflation and real estate bubbles.[3]

Any prognosis for the Chinese economy needs to consider several clusters of problems:
> a manufacturing sector launched on snapping together imported component; foreign-ownership of manufacturing and services, and global cartels directing supply chains;
> regional government insolvencies; a banking system carrying undisclosed loads of doubtful debt; a stock market corrupted by state policy, and primitive bond markets;
> massaged statistics and lack of transparency;
> excess capacity; unproductive infrastructure; and no nation-wide market;
> turbulent workers, peasants and nomadic unemployed.

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[1] Karl Marx, *Theories of Surplus-Value* (*TS-V*), Progress Publishers, Moscow, 1968, Part II, pp. 500 and 519; *TS-V*, Progress Publishers, Moscow, 1971, Part III, p. 122.
[2] Karl Marx, *Capital*, III, Foreign Languages Publishing House (FLPH), Moscow, 1959, p. 485; Penguin, Harmondsworth, 1981, p. 616.
[3] Ross Garnaut, Jane Golley and Ligang Song (eds), *China: the next twenty years of reform and development*, ANUE Press, Canberra, 2010, pp. 273-4.

On top of these internal issues, China is vulnerable to contractions in demand for its products from a world clogged by recurrent crises in the accumulation of capital. Despite this catalogue of self-acknowledged woes, the Chinese miracle remains the envy of the world and the Chinese leadership promote their economy as the 'Engine of the World'. (*BR*, 30.12.10: cover) Do the very big numbers stack up?

Bigger than whose?

One corrective is to ask how big the very big numbers are.[4] David Hume thought that few people in the Age of Enlightenment could conceive of even a thousand. Now the upper figure in Australia is closer to a thousand thousands to match house prices. Beyond that cool million, comprehension collapses into what Douglas R Hofstader refers to the 'Number Numbness' that overwhelms most of us when dealing with 'Very Big Numbers', also known as 'zillions'. For instance, extrapolating from the population of 1.3bn tells us as much about the problems that China faces as it does about its ranking in the global order. As on the battlefield, the days when victory went to the biggest battalions are long gone. Although erstwhile head of Western Mining and BHP, Sir Arvi Parbo, fears that the world is becoming less predictable, he is certain that some of the 'contradictions and strains and stresses in China … are of massive proportions as everything in China tends to be'. (*Age*, 14.2.11: Bu7)

Two scare factors are the pace of China's expansion and its take-over of off-shore assets. On the first, a recent poll in the US of A reported that 47 percent thought that China was the leading economy against 31 percent who believed that their imperium retained the crown. (*SCMP*, 15.1.11: B3) The latter group was correct. According to the *Economist* Intelligence Unit, US GDP in mid-2010 was two-and-a-half that of China's at $US5,88bn; GDP per head was $US40,260 against $US7,500. China's growth rate of 8 percent is the minimum needed to keep its economy from falling over. Five percent equals stagnation.[5]

On the second alarm, it is a fact that China's reserves had doubled from one trillion dollars in 2006 to two trillion by mid-2009 and are approaching three trillion. (*FT*, 18.1.11: 6) However, this treasure chest is not a share raider's delight. The combined foreign direct investment (FDI) by the big four newcomers - Brazil, Russia, India and China - is less than that of the Netherlands. Two-thirds of China's FDI goes to Hong Kong and Macao; its next biggest destinations are the Cayman and Virgin Islands. The $2.8 trillion of foreign-exchange reserves that China held in December 2010 contrast with the $63.7 trillion available to the top 500 asset managers in the West. Moreover, Chinese reserves amount to only $1,900 for each Chinese but $5,600 for a South Korean and $8,400 for every Japanese.[6]

In what must strike many as a paradox, the chairman of China's central bank, the Peoples Bank of China (PBC), contends that 'the reserves are actually a

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[4] Douglas R Hofstader, *Metamagical themas: questing for the essence of mind and pattern*, Basic Books, New York, 1985, pp. 115-35.

[5] Ling Yang and Michael L Lahr, 'Sources of Chinese labor productivity growth: a structural decomposition analysis, 1987-2005', *China Economic Review* (*CER*), 21 (4), 2010, pp. 557-70.

[6] Peter Nolan and Jin Zhang 'Global Competition after the Financial Crisis', *New Left Review* (*NLR*), 64, July-August 2010, p. 101.

manifestation of the country's balance sheet and not real wealth'. The *Financial Times* explained what Xiao Gang meant:

> In China, the central bank prints money to buy the foreign exchange earnings generated by the country's exporters … the motive is to peg the renminbi to the dollar at what many believe is an undervalued rate. As Mr Xiao puts it, the policy comes 'at the cost of pouring huge amounts of base money into the domestic market'. (*FT*, 18.1.11: 6)

The objective, he adds, is to restrain inflation by sterilising liquidity from the trade surplus, a time-honoured maneouvre, which also affects the exchange rate.[7]

The panic-cum-euphoria about China is exceeded for muddle-headedness by coupling its prospects with those of India. In fact, India's GDP is a quarter of China's and a third per head at $US1,300, which is below that of PNG. India's average income is less than half that of China (*Economist* Intelligence Unit, 2010) and is placed 119th out of 169 nations on the UN's Human Development Index, just above Timor Leste; adult Indians have an average of 4.4 years of schooling compared with 7.5 in China. In the obverse of China, India is suffering from a shortage of investment funds, and inflation at two to three times the rate in China. (*AWSJ*, 17-19.12.10: 6) All the while, New Delhi contests a fifth of its territory with the Naxalite insurgents and is in danger of nuclear war with Pakistan. Adding 1.2 billion Indians to 1.3 billion Chinese puts commentators at the dead zone of the 'numbness' that flows from very big numbers.[8]

A bear in the China shop

One exception to the China-market bulls is a hedge-fund manager from Fort Worth, Mark Hart, who, in November, began betting on the implosion of 'an enormous credit bubble'. Hart had enriched himself by anticipating the sub-prime and EU collapses. He pitched his new fund with a list of the cracks in China's prosperity, starting from excess capacity of a third in cement and 200m. tonnes of steel. Both of those industries depend on the construction sector where, Hart claims, there are already three billion square meters of unoccupied floor space, with more becoming available. Investors dare not reduce rents to attract tenants because, in the eight largest cities, the ratio of property prices to rent is almost twice what it was in the US when its housing bubble burst. Bad loans match bank equity. Hart alleges that China's debt-to-GDP ratio is over 100 (*SMH*, 30.11.10: BU 8), twice the official figure (*BR*, 14.10.10: 29), and so above the EU average of 80 percent.

All these burdens, except the debt ratio, are acknowledged by Chinese officials. The difference is that they almost never add them up to a catastrophe within three years, which is how long Hart is prepared to ride out losses before his wager pays off. The ratings agency, Standard & Poor, is not persuaded. A month after Hart launched his China Opportunity Master Fund, S&P lifted China's

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[7] Early in January 2004, the *New York Times* reported: 'The central bank has been printing Yuan on a massive scale to buy dollars and prevent the Yuan's appreciation. The central bank has then taken some of the extra Yuan out of the financial system by selling bonds and withdrawing from circulation the money that is used to pay for them. (6.1.04: C1-2)

[8] Tarun Khanna, *Billions of entrepreneurs: how China and India are shaping these futures – and yours*, Harvard Business School, Boston, 2007; Clyde Prestowitz, *Three Billion New Capitalists: the great shift in wealth and power to the East*, Basic Books, New York, 2005.

sovereign-credit rating one degree to double-A minus (*AWSJ*, 17-19.12.10: 3). That agency had given Triple-A to the Collatoralised Deposit Options at Credit Suisse just before they lost half their face value in 2008, and continues to put a Triple-A on the US government where the external debt to GDP ratio is indisputably over 100.

Scholars, officials and journalists note the failings reported below. Few contemplate a debacle by drawing together the disproportionalities of China's growth and the consequent limits to it. What follows is a summary of reports in the quasi-official *Beijing Review* and other media, backed by academic articles and books, which together allow us to weigh up whether the current global crisis will prove a catalyst for the next stage of China's expansion.

Since it is against Australian law for unregistered persons to give financial advice, I shall offer the two rules of thumb for getting truly rich. Rule One: make lots of people work for you. Rule two: either accumulate capital from the surplus value produced by those workers, or swindle other capitalists who already have done so. In our era of excess capacity, there are fewer prizes from the exploitation stakes. Thus, the smart money is on the biggest swindles. So, do you bet on a China meltdown by placing a million or two from your next Lotto win with Hart's hedge fund? For mugs like me, the safest bet for my Lotto millions seems to be to copy those Chinese who store gold bars under their beds.

'Not All Rosy'

Under the headline 'Not All Rosy', *Beijing Review* announced in October that 'China maintains financial health, though risks loom large':

> While the Chinese economy is staging a swift rebound, a bright outlook is not fully assured. The foundation of domestic demand remains shaky and private investments have yet to become a significant driver of growth.

The article outlined 'risks' from overdue credit-card debts, local-government insolvencies, 'proliferating inflationary jitters and the housing frenzy' fueling 'real estate bubbles currently in the making across the nation [that] have stretched the nerves of policy-makers'. (*BR,* 14.10.10: 28-29)

Behind these storm clouds hover cautions from any number of Chinese authorities against over-heating. An academic member of the Central Bank's Money Policy Committee warned in November that the economy faces 'asset bubble risks'. (*BR*, 18.11.10: 30) An end-of-year summary of the global crisis probed beyond its headline that 'Bubbles Pose the Biggest Threat' to ask whether the bubbles were 'structural' rather than contingent on the 2008 stimulus:

> Liquidity's blind chase after financial assets, properties, agricultural products and raw materials has lead to a surge in asset prices, exacerbated market speculation and added air to the bubbles in the economy. (*BR*, 23.12.10: 34)

More alarmingly, an author from the State Information Center pointed out that the decision-makers have to find a way beyond the 'decaying dividends' that have driven their economy for the past twenty years. (*BR*, 23.12.10: 34-5) The 'New Model' has to be implemented while all the external reference points are on a roller-coaster, and the domestic ones are lurching out of control. The Deputy-director of research of Ministry of Finance hoped to avoid 'a hard landing'. (*BR*, 23.12.10: 30)

Radical doubts

Scepticism is essential to science, although we need not apply Descartes' 'hyperbolic doubt' to every case.[9] In the domain of human affairs, it is enough to operate on the principle of the late investigative journalist I F Stone that all governments are run by liars and nothing they say should be believed merely because they have said it.[10] In the case of China, my engagement with Maoism taught me never again to believe stories from places about which I knew next-to-nothing.[11] Here, I employ official sources when they bring bad news.

The unwillingness to discuss the fault lines in the China boom has grown the more the Australian media intone that the coming thirty-year boom will keep us safe from the 'perennial gale of creative destruction'[12] that carries capitalism forward, and which burst out again in 2007. Marxism and scepticism preserved me from the recurrent claims that the cycles of boom and bust had been replaced by an horizonless plateau. I saw the dot.com flopperoo of 2,000 from a mile off.[13] At the 2003 Adelaide Festival of Ideas I gave a paper entitled 'Can Capitalism Collapse?' (see Festival website) Four years later, I picked up the warning from the International Bank of Settlements that global capital faced the prospect of an implosion as ferocious as the 1930s depression. At the time, *Crickey* declined to carry my response as 'too depressing' (now on my website).

A further reason to pause is that, in 1988 and 1989, the experts pictured Japan as they project China today, as the next imperial power about to overtake the US of A economically and militarily, at least in the Pacific Rim.[14] In 1990, Japan Inc. slumped into a deflationary cycle from which it shows few signs of escaping. (*Japan Times*, 31.12.10: 7) China's overtaking of Japan as the world's second largest economy in the middle of 2010 is paraded as proof that China is on its way to the top. That ranking should also be a reminder that – once upon a time - commentators pictured Japan as headed there. Also worth remembering is that Japan's GDP per head is still ten times greater than China's.

Once bitten, twice bitten

The failure to question China's future is endemic in Australia where the economy is again being derailed by mineral exports. In the era of deregulation, policy makers are left with no strategic options beyond predicting that the China boom

[9] Rene Descartes, *Discourse on Method, and other writings,* Penguin, Harmondsworth, 1960, pp.101-6; Janet Broughton, *Descartes' Method of Doubt*, Princeton University Press, Princeton NJ, 2002.

[10] Myra MacPherson, *'All Governments Lie', The Life and Times of Rebel Journalist I F Stone*, Lisa Drew/Scribner, New York, 2006.

[11] see my 'Where did correct ideas go?', from *Australian Book Review*, September 1999, pp. 23-28 on my website www.alphalink.com.au/~loge27

[12] Joseph Schumpeter, *Capitalism, Socialism and Democracy*, George Allen & Unwin, London, 1947 edition, p. 84.

[13] *Bulletin*, 23.5.09, pp. 64-5; this item appeared after the collapse had started though I had pitched its contents earlier, which is why the editor knew to ask for it. The piece grew out of my research for *The Essence of Capitalism*, Sceptre, Sydney, 2001, pp. 59-70.

[14] Clyde Prestowitz, *Trading Places*, *How we allowed Japan to take the lead*, Basic Books, New York, 1988, in 2005, he published *Three billion New Capitalists*, merging India and China. Will Hutton offered a counter case in *The Writing on the Wall*, China and the West in the Twenty-first century, Free Press, NY, 2006. In 1990, Bill Emmott had done much the same with *The Sun Also Sets, The Limits to Japan's Economic Power*, Touchstone, New York, 1990; as editor of the *Economist*, Emmott maintained his support for the US imperialists in his 2008 *Rivals: How the Power Struggles between China, India and Japan will Shape Our Next Decade,* Allen Lane, London.

will go on, and on. Australians have been down this yellow-cake road more than once before. Our forebears believed that they would grow rich if only the Chinese wore woolen socks and put sugar in their tea. In *The Glugs of Gosh* (1917) poet C J Dennis portrayed his fellow Australians as exchanging

… pianers and pickles and spanners
For seventeen shiploads of stones.

From the late 1950s, Australians transferred that cargo-cult mentality across to Japan's mineral imports, leaving Australia 'a lucky country run mainly by second-rate people who share its luck', as Donald Horne recognised in1964. Until Rex Connor became Minister for Minerals and Energy in 1973, no Swank of Gosh had thought it necessary to put a number on 'the contribution of the mining industry to Australian welfare'. The answer came in the 1974 Fitzgerald *Report*, which calculated that, far from adding to the national coffers, the Australian tax-payer had subsidised BHP, CRA and Aloca to ship our dirt to Japan to the tune of $137m.[15]

Five years later, then Treasury Secretary John Stone warned that a coming boom in energy exports meant that we must dismantle our still substantial manufacturing sector to manage a new bout of currency appreciation.[16] Stone's resources boom confirmed 'Banjo' Paterson's conclusion from observing cattle booms and Northern Territory booms: 'They all went bust'. Within seven years of Stone's *pronunciamento*, treasurer Keating was bleating about a banana republic as the exchange-rate plunged.

Statistical inflation

These memories and experiences would have done no more than keep me wary of a China boom. The catalyst for my becoming a China sceptic was a 2003 article titled 'Gold into Base Metals' in one of the most prestigious publications in bourgeois economics. From an examination of the evidence between 1978 and 1998, its author, Alwyn Young, documented the unreliability of Chinese statistics, thereby turning 'the extraordinary into the mundane'.[17] My mentions of Young's evidence encountered blank stares, although *Crickey* accepted a version in mid-2007. Because of the seminal place that Young's article had in my outlook on China, and because so much of the popular belief is based on very big numbers about its growth, I shall open with his material.

Instead of fiddling with the final figures published by central administrators, Young tracked how those results had been constructed from the results forwarded from below. Lower-level officials were rewarded for meeting expectations and punished for failing to come in on target, as had been the case for millennia. From time to time, the central authorities tried to correct the errors. For instance, 'the 1994 gross industrial output estimates were revised downward by about 9 percent'. That year, the government identified 70,000 cases of misrepresentation. Another reason for the gulf between the hype and the performance has been a 'systematic understatement of inflation by enterprises'. Young concluded that 'the growth rate is not the highest in all

[15] *Australian Parliamentary Papers*, 1974, volume 8, no. 3; for context see my *Gone Tomorrow, Australia in the Eighties*, Angus & Robertson, Sydney, 1982, pp. 83-86.
[16] quoted *Gone Tomorrow,* p. 160.
[17] Alwyn Young, 'Gold into Base Metals, Productivity Growth in the People's Republic of China during the Reform Period', *Journal of Political Economy*, 111 (6), November 2003, pp. 1220-61.

recorded human history, but at levels previously experienced by other rapidly growing economies'. He reckoned that labour productivity had increased by 2.4 percent a year on average, and total factor productivity by 1.4 percent, which was 'respectable but not outstanding'. Those improvements had come from the shift of peasants into industry, an explanation confirmed in 2009;[18] the increase per capita had been assisted by the one-child policy.[19]

Because Young's investigation goes up to only 1998, his results do not rule out that growth and productivity have increased since then, or that the statistics have become more reliable. However, other experts have doubted the high-flying numbers. In 2004, a researcher from the Beijing Statistical Office, Zianchun Xu, discussed the confusion following the 1992-95 switch in national accounts from Soviet-era material product calculations to the United Nations' System of National Accounts, which includes more services, for which productivity is more difficult to quantify.[20]

At the same time, Carsten A Holz, from Hong Kong's University of Science and Technology, reported other criticisms by Chinese officials of their statistics. Holz complained that none of the internal critiques allowed a researcher to reconstruct household consumption. Furthermore, the relationship between the GDP component of household consumption and the underlying data varied from year to year, making comparisons across even brief timespans unreliable.[21] After the 2004 Economic Census, Holz looked at the very big numbers to conclude that 'the 2006 benchmark revision implies that Chinese statistics have to be taken with a rock of salt'.[22]

The need to fake figures became extreme in the aftermath of the 1997 Asian financial crisis when the leadership decided to carry the pain of stabilising the region for fear that a free fall of neighbouring currencies would wreck the world economy.[23] The national statistics showed neither the full impress from the crisis nor the costs to China of its not joining the stampede to devalue. At the University of Pittsburg, Thomas Rawski gathered 'proxy' data on inventories, steel output and unemployment to conclude that the GDP claims could not be right.[24] He calculated that the cumulative growth rate from 1998 to 2001 was anywhere between 0.4 and 11.4 percent against the official 34.5 percent.

Some behaviours, it seems, are not susceptive to harmonious reform. Late in 2008, the head of research for Standard Chartered Bank in Shanghai, Stephen Green, asked a local executive with the PBC for the city's growth rate: 'The city

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[18] Yang and Lahr, 'Sources of Chinese labor productivity growth', *CER*) 21 (4), 2009, pp. 557-70.
[19] David Hale and Lyric Hughes Hale, 'China Takes Off', *Foreign Affairs*, 82 (6), Nov-Dec 2003, p. 39. Hereafter, page numbers are given in the text.
[20] Xianchun Xu, ' China's gross domestic product estimation', *CER,* 15 (3), 2004, pp. 302-322.
[21] Carsten A Holz, 'Deconstructing China's GDP statistics', *CER*, 15 (2), 2004, pp. 164-202.
[22] Quoted Stephen Green, 'Lies, Damned Lies and Chinese Statistics', *Far Eastern Economic Review*, *Magazine*, January/February 2009, p. 16.
[23] Shalendra D Sharma, *The Asian Financial Crisis, crisis, reform, recovery*, Manchester University Press, Manchester, 2003, chapter 5.
[24] Quoted Green, pp. 14-15; Rawski has co-edited the stolid *China's great economic transformation*, Cambridge University Press, Cambridge, 2008.

reported 10 percent, but there's no way it really was that. But they would not dare report anything less'.[25]

Young, Xu, Holz, Rawski and Green offer grounds for taking a sharper look at the writing on the great wall. I shall now sketch some of the obstacles to China's uninterrupted growth, starting with excess liquidity which is the gravest danger because of its interlock with inflation, government and bank insolvencies, revaluation and bubbles.

Liquidity

It is a fact generally acknowledged that China is awash with ready money. The 2008 stimulus lifted the volume of cash and realisable assets [the broad money supply, known as M2) to twice the Gross Domestic Product (GDP) during 2010, an increase of 20 percent year on year, well over the target of 17 percent. (*BR*, 3.2.11). China has the world's highest money stock. Although this spike is recent, M2 had been growing five times as fast as GDP since 1978. (*BR*, 18.11.10: 30)

In November 2009, erstwhile central planner and banker, economics professor Yu Yongding warned a Melbourne audience that the stimulus that year had pushed bank credit up by $1.15 trillion in the first half, which was twice the government's target for the twelve months, and twice that for 2006 and 2007. Asset bubbles, excess capacity and inflation were leading his country towards another round of deflation, worse than that of October 2008. (*Australian*, 26.11.09: 21)

The authorities now want to hold the M2 increase at 14 percent per annum. To regain control, the PBC increased the reserve requirements for financial institutions six times during 2010 to reach a record 19 percent for some of the largest banks. (*SCMP*, 21.12.10: B1) Nonetheless, new loans during the first nine months of 2010 were a 'dizzying' $US944bn (*BR*, 28.10.10: 29) and for the full year exceeded the announced limit by $US1bn. (*SCMP*, 15.1.11: B1; *BR*, 3.2.11) A seventh increase came into force on 20 January, withdrawing $US500bn (*SCMP*, 15.1.11: B1), at the same as the PBC initiated tougher inspection measures. (*CD*, 6.1.11:14) The eighth rise on 19 February indicated that the efforts to deflate the bubbleconomy were not going to plan as inflation nudged 5 percent. (*AFR*, 21.2.11: 1 & 14)

As a mark of urgency, the PBC raised its lending rate in October, the first time in thirty-three months, and did so again on Boxing Day, and again on the eve of Chinese New Year reach 6.06 percent. (*SMH*, 10.2.11: B6) Increasing the bank rate is a standard device for controlling liquidity. In today's China, however, such increases are likely to have the opposite effect because its rates are positive at a time when those across the developed world are zero or negative. The upshot is that the higher goes China's interest rate, the more hot money is sucked in, driving up liquidity. (*BR*, 16.12.10: 29)

Some experts advocate extending certain stimulus policies for at least one year to promote sales; a few argue for a second package. Those outlays will be fiscally responsible since revenues rose by 22 percent last year, but would be a monetary disaster through boosting liquidity, as is accepted by even the most

[25] Green, p. 14.

relaxed of the academic commentators. (*CD*, 12.1.11: 9) No monetary target was announced for 2011. (*BR*, 20.1.11: 36; *AWSJ*, 20-21.1.11: 28)

China needs to practice 'loose fiscal and tight monetary' policies, said another senior spokesperson for the State Council. (*BR*, 18. 11.10: 31) It should be no surprise that the authorities find it easier to do the former. Conflict within the leadership goes beyond selecting a means to limit the money supply. Many officials fear that any contraction will injure the wellsprings of their patronage and personal enrichment.[26] Corruption at the very top has gone past raiding the public purse to the setting of policies that sustain 'opportunities to sell off their assets at high prices'. (*NW*, 17.1.11: 27) In addition, the leaderships are confronted by the politics of dealing with an economy torn between overheating and contractions. Too abrupt an end to the stimulus will add to unemployment whereas its prolongation injures those who are in work by pushing up their cost of living. Social and labour unrest is already widespread. The fear at the top is that a greater squeeze on real wages will provoke political challenges.

Inflation

Controlling inflation was top of the agenda when the annual Central Economic Work Conference met in December, endorsing a switch in monetary policy from 'moderately loose' to 'prudent'. (*BR*, 23.12.10: 28) The official hope now is for an inflation rate of 4 percent across the next five years to displace the long-standing aim of 3 percent. Far from approaching either target, the Consumer Price Index (CPI) went above 5 percent in November, while the wholesale index was over 6 percent. (*BR*, 23.12.10: 36) A senior researcher at the State Council then warned that the CPI could hit 6 percent before sticking between 4 and 5 percent for several years. (*SCMP*, 21.12.10: B1) January's snowstorms might drive the CPI as high as 8 percent. (*SMH*, 10.2.11: B6) Housing costs remain a long-term source of upward pressure on the CPI so that is no longer possible for working-class households to afford to buy into most cities. (*BR*, 23.12.10: 31) Despite the over-supply of housing and office space, prices and rents are being maintained because 'deep-pocketed developers have capital reserves'. (*BR*, 28.10.10: 33) These aspects are examined below under 'Real Estate Frenzy' and 'Construction'.

The new element on the inflation front was a surge in food prices, up by 12 percent in November compared with that month in 2009: 'In the first ten days of November, the average wholesale prices of eighteen vegetables in thirty-six cities surged 62 percent from the same period last year'. The reasons behind those increases were not natural disasters but fallouts from the economic problems identified throughout this paper:

> In the past, stocks, property and coal were the big three magnets for private speculative money. But due to the integration of coal resources, the crackdown on property bubbles and the stock market slump, private capital has started flocking to agricultural products, whose prices are relatively low and easily manipulated.

The State Council responded with subsidies and more inspectors. (*BR*, 23.12.10: 34) These measures did not touch the root causes of too much cash and too few outlets for productive investment in the real economy.

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[26] Victor C Shih, *Factions and Finance in China*, elite conflict and inflation, CUP, New York, 2008.

Local government insolvencies
The largest single source of excess liquidity was the 'reckless' bank lending to regional governments as part of the 2008 stimulus. The Regulatory Commission considers about a quarter of the $US1.14 trillion in loans to be 'serious default risks'. Local authorities borrow to provide roads and other infrastructure, and chase debt because they are no longer allowed to issue their own bonds, while Beijing takes a majority of local taxes. (*BR*, 14.10.10: 29)

The bromide is that central government revenues of $US528 billion, which are slightly more than those of the regional governments, will underwrite any failures. China recorded a fiscal surplus of $US128 billion for the first nine months of 2010 which, its spokespeople say, means that 'a debt crisis is almost impossible'. At the same time, they report that the rate of increase in revenues fell during the year as the costs of urbanisation demanded outlays on the environment and welfare. (*BR*, 28.10.10: 29) One alternative is for the central government to take on more debt since official figures put the debt-to-GDP ratio below the fifty percent mark. (*BR*, 14.10.10: 29)

In the worse case scenario of all the bad loans failing, the central government would need to outlay almost half of its income to cover the lenders. Almost as alarming is a suggestion that more of the local-government loans be securitised to diversify the risks. (*BR*, 14.10.10: 29; *The Banker*, June 2010: 68) That protection sent sub-prime mortgages viral. Shadowing the insolvencies is the real-estate boom. Regional debts are guaranteed by land valuations, which are threatened by efforts to deflate the bubble. If revenues from land sales shrink, even more local governments loans will go bad. (*BR*, 14.10.10: 29)

Big brother?
The limits to central authority became apparent in two attempts to keep a lid on bad debts around the regions. Only in May 2009 did the State Council ban local administrators 'from making illegal guarantees'. Not until August 2010 did a quartet of Beijing agencies tell banks not to lend 'without a stable source of repayment funds'. (*BR*, 14.10.10: 29) Printing that circular was easier than enforcing its prescriptions. China is not a totalitarian society where orders are obeyed at once and without question. That was not the case even under Mao, and is a long, long way from the situation today. The collapse of the command economies demonstrated that production and consumption are not functions of planning decisions.

The difficulties in controlling so sprawling and populous an economy as China's have been compounded by market forces. The Party can no longer promote probity by putting politics in command or draw on the moral authority of 'serving the people'. The system is dictatorial and capable of brutality but decisions of the central leadership are not implemented promptly or fully. Regional centres strive to become independent fiefdoms where corruption and repression are more blatant if no more rampant than around the Summer Palace.[27]

Corruption and other illegalities supply a solvent of flexibility for authoritarian regimes. However, certain manifestations are blocking the changes

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[27] Graeme Smith, 'Political Machinations in a Rural County', *China Journal*, 62, July 2009, pp. 29-60; Ben Hillman, 'Factions and Spoils: Examining Political Behaviour within the local state in China', *China Journal*, 64, July 2010, pp. 1-18.

needed to transform savings and investment. The New Year began with the exposure of one such case when the National Audit Office charged the two largest insurance companies with offences totaling $US450m. The sector has assets of nearly $US800bn but Beijing limits its access to capital markets because of 'rampant misuse and embezzlement of funds'. (*SCMP*, 1.2.11: B1)Until those behaviours are contained, reliable credit and bond markets for an economy driven by domestic demand will remain beyond reach.

Given the challenges that graft and swindling pose to the Chinese economy and polity, its elites are not about to adopt the protracted processes of the Common Law. Executions are publicised across China as a deterrent and reported abroad to reassure foreign investors.[28] If the death penalty were 100 percent effective at combating corruption, there would be no need still to carry out executions. How much worse would corruption be if the moral hazards did not include a firing squad?

China's top leaders have an administrative dilemma – how to cleanse a stable which they themselves foul and which fertilises their fortunes. This year sees the institutionalising of the two-tier approach that has operated since the 1980s. (BR, 20.1.11: 18-21) Lower-level cadres who steal or take bribes are to be subject to stern penalties. The higher echelons that have already enriched themselves are safer from arrest but have to fight within the state apparatuses for policies that will allow their investments to prosper, above all in property development.

Real estate frenzy

Nowhere is the central government more anxious to control economic activity than over the real estate bubbles before they burst. (*BR*, 28.10.10: 32) Nowhere are the limits to Beijing's authority clearer. In March, the State Council ordered an end of loans for property development to seventy-eight central enterprises whose core business is not real estate. By December, only seven had complied, and all of them were trying to unload unprofitable subsidiaries for which there were few takers. The reason why businesses moved into property development also explains why they do not exit as instructed: 'The real estate industry has a profit rate between 30 and 45 per cent, much higher than the average profit rate of 5 per cent in manufacturing', according to the manager of the Guangzhou Jingweixing Research Center. (*BR*, 16.12.10: 32)

The distance between instructions from Beijing and implementation around the countryside also appeared in attempts to constrain the funds pumping up the property bubble. In April 2010, the State Council ordered restrictions on financing, land sales and credit. The effects of these regulations lasted only until August, while costs rose 9 percent in the year to September. To contain speculative construction, the government also announced a policy of one-unit per family, with deposits on second or third residential properties lifted to 50 percent of the purchase price. Nonetheless, in the first three quarters of 2010, real-estate investments shot up by 36 per cent, of which residential building took 70 per cent to add 1.2bn square metres, an increase of 63 per cent year-on-year. *Beijing Review* raised the possibility of a 'financial disaster', cutting

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[28] To keep up, George W Bush would have had to have extended his fondness for the death penalty to his cronies in Enron.

house prices by as much as half, before adding the rider that the government will not allow the problems to get out of hand. (*BR*, 28.10.10: 32-3)

Similarly, banks sailed around the limits set on loans to property developers by working through trust companies. (*AWSJ*, 17-19.12.10: 3)

> With massive credit expansion burning up capital, it is easy to see why such manoeuvres might be attractive and they are a way round loan quotas as well as capital and liquidity regulation. Sound familiar? (*The Banker*, June 2010: 68)

Late in 2010, banks rushed through loans before the promulgation of measures to deflate the bubble. (*BR*, 23.12.10: 37)

Construction

Far more of China's urban job growth has been in construction than manufacturing.[29] In 1994, manufacturing added 3.42m. workers but construction added 4.52m., while in 2002 the respective figures were 2.27m. and 6.11m. (*BR*, 16.10.03: 29) That China's transformation has been powered by construction and building is in keeping with previous industrialisations, if not with their written histories.[30]

The construction industry is not the same as the real estate sector. Their linkages and disjunctures get blurred because the same corporation builds and then rents. Moreover, urbanisation does not always contribute to capital accumulation. Investment is productive only when it adds value through the application of labour power. That extra has then to be realised into profit, a portion of which has to be reinvested. By contrast, real estate redistributes values added in the real economy. The production processes for an apartment block and for an automotive plant both add value. The labour on their construction adds surplus value and thus can expand capital. So does the construction of the cement works and steel mills that supply the raw materials and semi-finished goods to the construction sector. The erection of rail-lines, hotels or office blocks also generates surplus value.

What happens next is bifurcated. On the one hand, some building and construction projects go on contributing to the accumulation of values, for example, factories and ports. Rental housing, however, redistributes values that are mostly produced in other sectors. Shanghai's skyline is not expanding aggregate capital, not even if all the space is being let at rents equal to average profit.

After the 2008 stimulus, it became possible to spot white elephants among projects that previously had contributed to capital expansion. In the words of professor Yongding:

> The efficiency of the resulting mostly state-directed, infrastructure-centred investment has fallen by 50 percent, and was now below half that of Japan. … [It] would not bring returns … Due to the hasty and under-

[29] Most of the labour force arrives through networks of sub-contracting that begin with village recruits. Pun Ngai and Lu Huilin, 'A culture of violence: the Labor subcontracting system and collective action by construction workers in post-socialist China', *China Journal*, 64, July 2010, pp. 143-58.

[30] One exception is Linda Clarke, *Building Capitalism, Historical Change & the Labour Process in the Production of the Build Environment*, Routledge, London, 1992. Marx took very few of his examples of exploitation and expanded reproduction from building and construction, *Capital*, I: 344, 562, 621-2; II: 233-4 and 464; III: 149, 203, 210, 234 and 773ff; *Theories of Surplus-Value*, II: 243, 292 and 483; Frederick Engels, *The Housing Question*, Progress Publishers, Moscow, 1970.

> supervised implementation, waste in such construction is ubiquitous. (*Australian*, 26:11:09: 21)

Tower blocks and freeways are impressive backdrops for action movies.

Foreign devils

The more one delves into the actualities of China since the start of its market programme in the early 1990s, the more its industrialisation appears odd, and not merely scored with Chinese characters. For a start, China is unique in combining a transition to capitalism from socialism with its industrialisation, and doing both within twenty years. One other peculiarity is the degree of foreign ownership, which contrasts with pre- and post-war Japan where, like its medieval fortresses, neither a mouse nor a ninja could enter. By 2003, Foreign Direct Investment (FDI) in Japan still accounted for 'only 1.1. percent of GDP, compared with over 40 percent in China'. (Hale: 38)

China's take-off followed Deng Xiaoping's 'Southern Tour' in 1992 when he praised Enterprise Zones in which foreign firms were offering a solution to the unemployment forced on forty millions by the restructuring of State-Owned Enterprises (SOEs). FDI shot from less than $US3 billion in 1990 to a total of $US381 billion by 2003,[31] when firms with FDI accounted for half of China's exports and 60 percent of its imports. In 2,000, US investments in China generated profits of $7.2bn against $4.6bn from Mexico. (Hale: 38 and 48)

By May 2010, the $US576bn of FDI inside China was twice the volume of its investments overseas, increasing by over 17 percent during the year:

> China's surplus with the United States is mostly generated by foreign-funded or foreign-owned companies in China, which produce nearly 88 percent of Chinese exports to the United States.

Foreign investors take away the lion's share of the profits. Out of every ten dollars of profits made from exploiting Chinese workers, seven or eight go to foreign firms. (*BR*, 4.11.10: 30) For instance, US laptop brands take 50 percent of the profits from exports of models assembled in China, whereas the ones made entirely in China earn about 5 percent. (*CD*, 6.1.11: 14) US firms have a large slice of the Chinese market for services, with up to $20 billion in profits out of revenues of $220 billion from banks, insurers, auditing and legal work. Now that China represents more than a quarter of the global sales of luxury goods, manufacturers who set up 'through joint ventures or franchises are buying back their distribution rights'. (*BR*, 6.1.11: 37)

What are the medium and long-term consequences of expatriating so much of the profit? How much local accumulation is happening? 'Accumulate! Accumulate! That is Moses and the Prophets!' Marx wrote is the rule of the game under the rule of capital.[32] The point in exploiting labour and plundering nature is to garner larger sums of money to re-invest. Businesses in China are doing plenty of that – but many are expanding foreign capitals to a degree that had no parallel in the industrialisation of Britain, Germany, the US of A and Japan, but is more like the relationship between the Netherlands and the East Indies. Anger at

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[31] Ronald I McKinnon, *Exchange rates under the East Asian dollar standard: living with conflicted virtue*, CUP, Cambridge, Mass., 2005, p. 157.

[32] Karl Marx, *Capital*, I, FLPH, Moscow,1958, p.595; Penguin, Harmondsworth, 1976, p. 742

the reappearance of 'Treaty Ports' and neo-colonialism extends to champions of the free market.[33]

Cartels

Even the Chinese-owned capitals are locked out of the flows essential to succeed on the global stage.[34] A recent article begins by noting that, although China's exports overtook Germany's in 2009 to become the world leader, 'Chinese companies face enormous competitive challenges in operating on the international stage'. China's manufacturing and banking are not integrated into the global networks. Instead, 'they have to compete with the powerful firms that now dominate almost every segment of global supply chains'.

Only construction equipment has a level of concentration below 50 percent globally. The second lowest is for PCs at 55 percent and third is mobile handsets at 65 percent. While the ranking of Chinese capitals advanced during the current crisis as their rivals slid down the ladder of global giants, US and EU firms also strengthened their position through further concentration. China still does not appear among the top ten corporations in nine out of the ten key sectors.

China got onto the 'finance' list of the world's largest in part because of the drop in the market capitalisation of US houses but mostly because the Chinese banks dominate their own turf. (*The Banker*, April 2010: 106) They are huge at home but not globally networked. As Nolan and Zhang put it:

> It requires a huge leap to progress from being a powerful domestic bank, operating in a heavily protected home market, to one that is globally competitive and able to finalise large-scale international mergers and acquisitions.

Without the links to carry through take-overs, can Chinese capitals buy their way into the other nine sectors? The obstacles were demonstrated in the 2009 blocking by other nation-market-states of an offer by the Aluminum Corporation of China to inject $US20bn into RTZ.

Inevitably, the oligopolies dominate R&D, and thus have their hands on the future drivers. The vice-minister of Commerce complained early in 2011 that ' through its monopoly in technology and software, the US occupies the top end of the value chain'. (*CD*, 6.1.11: 14) As we have seen, they also dominate FDI across the globe. Hence, by every measure, Chinese firms are in the infancy of corporate clout.

For example, Chinese steel-makers have been hit by soaring ore prices, up by 56 percent in 2010. An industry spokesman worried that his members would not be able to reverse the trend because of the dominance by the three biggest suppliers – Vale, RTZ and BHP-Billiton – 'have sapped vitality out of China's steel industry'. (*BR*, 20.1.11: 37) This weakness contrasts with the monopsony that Japan presented to Australian-based suppliers from the late 1950s. The Iron and Steel Association welcomes the drive to concentrate production: 'With fewer

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[33] For a denunciation of this loss of economic sovereignty, see Huang Yasheng, *Selling China: Foreign Direct Investment during the Reform Era*, Cambridge University Press, Cambridge, 2003; and his *Capitalism with Chinese Characteristics, Entrepreneurship and the State*, CUP, Cambridge, 2008.

[34] Nolan and Zhang, *NLR*, 64, pp. 97-108.

faces at the negotiating table with exporters, China will have more bargaining power in setting a price'. (*CD*, 12.1.11: 14)

The challenges before the Chinese leaderships are qualitative as much as quantitative. After 1980, 'the age of globalisation witnessed the rapid consolidation of systems-integrator firms and their supply chains'. China's competitors retain advantages from nearly 150 years of installing management systems, domestically and around the planet. The non-Chinese corporations have increased their links and upgraded the barriers. Freed from the blinkers of economic correctness, it is not hard to see why 'free trade' from the 1980s opened doors to further oligopolising across the world.

Catching up by China is not just a matter of its workers pushing out more and cheaper cars or tie-pins. It also involves the 'visible hand' of management beyond the factory gate to integrate finance with supply, production and distribution. Chinese executives are capable of performing such soft-power functions. At issue is whether they will be able to buy their way through the gate of earthly profit. Or will they be checked by a new great wall – one that keeps the Chinese in, not the barbarians out?

China's strategic environment is hostile economically and politically, unlike the 'miracle' decades of reconstructing Germany and Japan, which the US imperium built up as its front lines against the Soviets. By cutting deals with rogue states, Chinese capitals seek to surpass some of the barriers erected by the supply cartels and financial oligopolies buttressed by their nation-market-states.[35] The opportunities for such back-door arrangements will spread as more crisis-stressed corporations break ranks to gain cash flows. The Great Wall Against China is not impenetrable, but it is high and broad.

Hence, in projecting China's future, we need to think beyond its 1.3bn people and the volume of their output to recognise that Chinese capitals have to meet the same needs as capital anywhere. Expansion requires more than the exploiting of labour to extract surplus value – at which Chinese-based firms excel. In Volume II of *Capital*, Marx traces the cycle of expansion from money through production to vendible commodities from which to realise the profit essential to provide more money to invest. (See www items in Capital Refined) Nolan and Zhang document how the global concentration of capital stands in the way of Chinese capitals being able to grow as fast as they might.

Monopolising

China's hand in dealing with the cartels is weakened because its own industries remain fragmented. Above all, there is no national market. Under socialism, the command economy was centralised far more than concentrated. Mao encouraged local industries as a defence-in-depth, as well as for the ideological impact of bringing peasants into contact with industrial processes. China is not unlike Europe before the Economic Community started in the 1950s. The centrifugal forces tearing at the EU are a reminder of the protracted processes behind installing a seamless market. Vehicles and ferrous metals illustrate how far China is from having that outcome in sight.

Out of 123 auto manufacturers in 2003, seventy had outputs of only 1,000 vehicles each, while two made more than 500,000. (*BR*, 25.9.03: 29)

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[35] Special issue on Africa, *China Quarterly*, 199, September 2009; *Financial Times*, 18.1.11: 6.

In 2010, a dozen joint ventures and some 100 locals divide up the vehicle market. Despite rapid expansion in the past three years, the industry looks like the US one until oligopolised by Ford and the du Ponts a hundred years ago.

Steel-making is worse, structured like the free-market of multiple medium-sized firms in the UK and US of A before the 1880s. There are 800 producers, with only seventy-seven large and medium ones. (*BR*, 2.12.10: 37) China's five largest firms produce 30 percent of the iron and steel against around 70 percent in the US of A and Japan. The 2011-15 Plan aims to slash the number of producers by three-quarters to 200, with the ten biggest controlling 60 percent of output. Firms that refuse to comply will be denied credit and have their power supply cut off – if the local authorities comply. Some non-government producers fear that they will be landed with inefficient SOE partners, thereby leaving the sector no better placed. (*CD*, 12.1.11: 14) The squeeze on iron-and steel businesses follows the essential adjunct of a start towards integrating coal producers.

Deciding that concentration is essential to greater productivity, the State Council in September 2010 called for more and faster mergers and acquisitions, not only in the automobile and iron-and-steel, but also cement, machinery, manufacturing, aluminum and rare-earth industries. (*BR*, 7.10.10: 18-19) Once more, Beijing has to overcome resistance by local governments to takeovers from outside their domains, fearful of lost opportunities for corruption and nepotism.

Snapped together

Related to China's low place in the global production system is the degree to which its high-tech products are still being snapped together out of components from Japan, South Korea, Taiwan and the United States. Between 1995 and 2002, imports for reprocessing and re-export tripled to $US82bn. to run up trade deficits with East Asia. (Hale: 47) One more surprise for alarmists alleging that China is on route to taking over the world is how many of its exports are still assembled from imported parts. Early in 2011, vice-minister of Commerce, Jiang Yaoping, highlighted what he called

> 'the processing industry', in which multinational firms import intermediate goods from other countries and assemble them as finished productions in China before exporting them overseas … despite contributing only a portion of the manufacturing process, the finished product is recorded entirely as a Chinese export.

Yaoping linked this processing trade to his country's trade surplus, adding that the US capitals are the prime beneficiaries:

> About 80 percent of China's trade surplus with the US is created by US multinationals operating in China … Multinationals, especially those in the laptop sector, create more than 80 percent of the surplus, and the export of laptops contributes to about half of China's surplus in the processing trade.

His ministry reported that 90 percent of the world's laptops are snapped together in China. (*CD*, 6.1.11:14)

ChiNext

If you doubt the extent of snapping together, name a brand logo that summons up China – except 'Made in China'. Where is its Nokia or Sony, or even a Noritake? A joint venture with Japan has just launched a smart phone – Libero - in Tokyo. (*BR*, 23.12.10: 37) As we have seen, China exports the newest high-tech commodities, but few are of its own devising.

Britain industrialised on the basis of the most technically advanced machines producing low-tech cloth. Japan followed suit by going one step further in the manufacture of clothing, as is China. However, Britain, Germany, the US of A and Japan were developing industrial specialties in their formative decades. Chinese machine shops have gained certification from German authorities to supply rail wheels (*BR*, 7.10.10: 19) and its factories challenge Swatch at the low-price end of the watch market (*SCMP*, 24.1.11: B4) but the country is embarking on a joint venture with South Korea to establish a state-of-the-art steelworks.

The twelfth Five-year plan will pursue export markets, though fewer of the snapped-together varieties. The next stage is foreshadowed in support for innovative technology firms through the 'growth enterprise board', known as ChiNext, of the Shenzhen Stock Exchange (SZSE). Launched in October 2009, ChiNext attracted nearly $15 billion for more than 130 entrepreneurs inside its first year, creating sixty-seven 'magnates' worth an average of $US2 million.

The new companies are burdened with the world-wide weaknesses of financial swindles, made the more hazardous by so much liquidity 'sloshing' around in China. (*BR*, 30.12.10: 31) Hence, the SZSE General Manager, Song Liping, stresses the need for 'meticulous care':

> … what we are worried about is the excessive money supply, successively launched policies supporting strategic emerging industries, which may be used by the market for speculation, and aggravating fluctuations of small company stocks …

Top of the SZSE catalogue of recommendations is a delisting device to curb speculation while spotlighting the quality offerings.

From the start, the regulators had to deal with inflated prices of Initial Public Offerings (IPO), extravagant price-to-earnings ratios (P/E), and initial subscriptions running at two-thirds over the announced capital requirements. Song blames the artificial setting of IPO prices, and hopes that the China Securities Regulatory Committee will allow the market to decide. The firm with the biggest market value, Lepu Medical Technology (Beijing) Co., is capitalised at $US3.4bn although it reported a profit of only $45m. in the first nine months of 2010, a P/E ratio of 70, which the average for ChiNext.

SZSE officials fear a dot.com boom and bust from the floating, in the final quarter of 2010 of stocks allocated to employees before their companies went public. The release of these 'restricted' holdings will more than double the number of tradeable shares in ChiNext firms. The appearance of such shares on Wall Street in January 2000 exploded into the dot.com bust from March. (*BR*, 11.11.10: 31)

Shanghai Express

It is a moot point whether SZSE is a safer bet than the ChiNext businesses that it is supposed to regulate. Stock markets are always and everywhere snakepits. Wall Street regularly confirms that corruption is not the preserve of emerging markets but that swindling is part and parcel of the casino known as the stock

exchange. The relations between SXSE and the Party are no cosier than those between the White House and Obama's mobsters in Treasury Secretary Geithner and the recently retired chair of the National Economic Council, Larry Summers.

The following paragraphs have been extracted from an academic article about efforts by the Chinese leadership in 2005 to quarantine some of the corruption of the Shanghai exchange. The authors investigate

> a key institutional reform of the market that sought to address one of the major pathologies of the 'China Syndrome': state domination in the share structure, which led to severe price distortion, rampant speculation and investor predation in the market.[36]

The central authorities limited those problems but dared not eliminate their source in personal and institutional benefits. Before outlining the reforms, a snapshot will expose what had been going down.

Stocks plummeted steadily from 2000, with investors losing $US72bn in the two years to mid-2003. Nonetheless, panics along Wall Street created a mania for Chinese shares. New issues were being over-subscribed 700-to-1 on companies that had never paid dividends and had had their assets stripped before going on the market. 'Still a Gamble', warned *Beijing Review* (16.10.03: 32-33), adding 'That China's stock market serves to save ailing state-owned enterprises is no secret'. The government offered 104 state enterprises for sale but there were no takers after four months because the managers had pushed up the asset values. [37] (*BR*, 4.12.03: 18-19)

Now to present extracts from the article about the attempted purge:

The leadership treated the stock market as a platform to salvage the moribund state-owned enterprises (SOEs) by extracting funds from the public.

Correspondingly, the institutional design of the stock market and the broader financial system was to ensure the flow of the public's funds into the market. Through capital control, the public, with savings of around US$1.75 trillion by the end of 2005, were barred from investing overseas. In addition, the government lowered interest rates consecutively and imposed a 20 per cent income tax rate for bank deposits. Thus, with few alternatives, individual investors longing for higher yields were driven into the stock market.

Moreover, the Chinese stock market has been effectively state owned. More than 90 per cent of all listed companies were majority owned by the government; the two exclusive stock exchanges in Shanghai and Shenzhen are governmental institutions; most of the stock brokerages were set up by local and central governments, and most of the funds in the market were from state institutions and state banks. As (shareholding) SOEs, directors with government backgrounds formed the majority of the corporate directorate and management (average 73.5 per cent). Most of these 'key persons' were party cadres, government officials and former government members.

… The state was capable of overpricing its shares by restricting the supply side … The amount of initial public offerings (IPOs) was also controlled by the government through a quota system.

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[36] Stephen Bell and Hui Feng, 'Reforming China's Stock Market: Institutional Change Chinese Style', *Political Studies*, vol. 57 (1), March 2009, p. 117.

[37] Carl E Walter and Fraser J T Howie, *Privatizing China*, *Stock Markets and their role in corporate reform,* Wiley Asia, Singapore, 2003.

Most critically, the state had absolute ownership control over the listed companies through a share-splitting system. About two-thirds of the total shares of listed companies are held by the government, government institutions and other SOEs. These state shares and institutional shares (so-called 'legal person shares') cannot be traded openly in the market and can only be transferred privately or through irregularly scheduled auctions. Only the remaining one-third of shares available to public investors can be traded on the market.

The splitting of shares into tradable and non-tradable shares has been the central mechanism of state exploitation. By making the majority of state shares non-tradable, the state retained its ownership and continuous control of the publicly-listed SOEs. More critically, the circulation of only a small portion of the total shares in the market created an artificial premium on the tradable shares, a severe price distortion in both primary and secondary markets.
Another investigation estimates that the state generally paid only a tenth of market prices for its equity holdings.

Thus the dual-track pricing in the stock market, a discriminatory mechanism in favour of the state against minority shareholders, created distortions of the otherwise universal price signals of the market. This hampered the market's basic function of appropriate value identification and efficient resource allocation. It also created ample room for the controlling shareholders to exploit minority investors by writing off the equities on paper. For example, more than half of public investors' equities in the China Merchants Bank were lost within half a year since its Initial Public Offerings in 2002 in this way.

At the government level, the stock market served the political ends of the party state, particularly in SOE financing. Moreover, flotation of SOEs invited limited investors' scrutiny but perpetuated state discretion and poor corporate governance and accountability, therefore becoming an easy and cheap automated teller machine for the government's extra-budget funds. By 1999 almost all the central ministries had their companies listed in the bourses. Local (provincial) government had an especially strong incentive for tapping into the stock market for its financial resources. In order to get approvals for listing, many local governments acquiesced or even became involved in making fraudulent corporate financial reports to deceive the public.

However, the official banner of SOE finance alone cannot explain the enthusiasm of state officials and their cronies towards the stock market without referring to their personal gains from the dual-track system. Indeed, the stock market provided more liquid forms of assets (shares and/or cash) than other forms of public property. The plunder of public investment could be undertaken through what seem to be legitimate market transactions, which amount to a relatively covert form of money laundering. And disclosing such corrupt conduct was a daunting task, especially in a poorly regulated market and a judicial system that lacks the necessary professional expertise in relation to financial crimes. The state control of listed companies also ensured that the privileged few had insider control of the enterprises and informational advantages over other market participants. The huge economic interests encouraged many cases of institutionalised corruption in the IPO process as well as rampant and fake corporate disclosure and speculation in the secondary market. Therefore, a prominent Chinese economist saw the Chinese stock market as 'worse than a

casino': one cannot see the other's card in a casino game but one can in China's stock market because the card is in one's own hand.
(End of Extracts)

The conditions outlined are not ancient history. China led the world in IPOs in 2009 and 2010, accounting or 40 percent to the new capital raised globally, headed by the largest deal ever of $22bn for the Agricultural Bank in July. According to the Chief Executive of Lazard Capital Markets, 'The better companies coming out of China carry valuations that look relatively cheap for the amount of growth they can produce'. (*Australian*, 4.1.11: 19) If we recall the stampede into Chinese IPOs in 2000 with the current situation when there is a lot of money to place and few opportunities, then the broker's urging seems less reassuring. When China's equivalent to YouTube listed on the New York in December, its share price trebled on the day although it reported a monthly loss of $US2.7m, against revenues of only $4m. Small wonder that the Securities and Exchange Commission is probing so many of the Chinese newcomers for accounting frauds and carrying out 'IPOs through "reverse takeovers", or back-door mergers with dormant shell companies'. (*BR*, 6.1.11: 32-33) As with US scams, the US auditors had failed, many never visiting the factories they approved. (*Bloomberg Businessweek*, 17-23.1.11:58-63)

Bond markets
A Marxist expert on global finances, Michel Aglietta,[38] identifies 'well functioning bond markets [as] prerequisites for relaxing capital controls and as channels of transmission for an interest-rate led monetary policy'. By March 2007, he felt confident that the Chinese had righted their regulatory environment to be able to market corporate bonds again after the defaults in the 1990s. He concluded his paper to a Beijing Conference:

> Denying all the dire predictions made by Western Cassandras, the financial reform in China has been successful since its beginning after the Asian crisis. All the omens are that it will go on this way.[39]

No sooner had he assured his audience that they were on the silken road to a normal capitalist economy than the skein unraveled. Given that Aglietta was right to say that the State Council had been 'wise to forcefully restructure the banks and to subject them a strict supervision before considering an ambitious budget expansion', how would he characterise the relaxation of controls and the spending splurge since 2008?

On the specifics of installing a bond market, 'all the omens are that it will go on' limping towards the financial regime that he argues is essential for a market economy. Governments, banks and corporations held 97 percent of all the interbank bond market of $US2.1 trillion in mid-2010. Bank loans remained several times more important than bonds for investors.

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[38] Michel Aglietta, *A Theory of Capital Regulation, The US Experience*, Verso, London, 1987 edition.
[39] Michel Aglietta, 'Developing the bond market in China, The next step forward in financial reform', conference paper, Beijing, 27-28 March 2007, www.hKIMR.org/cms/upload/sem_paper_0_220_aglietta-paper070320

From the perspective of an inquiry into the real economy of 2011, the crux is whether top-down reforms across the financial sector had cleaned up the messes before the 2008 eruption. Allan Greenspan did not think so, warning on 1 October 2007 that the bubble of the Shanghai stock market must burst, though it should be noted that on the same occasion he announced that the sub-prime crisis was 'creeping closer to normality'. In proving him wrong, several New York bankers also derailed China's latest regulatory regime along with its monetary restraints.

Banking

Under the 2008-10 stimulus, levels of bank lending once again became 'unsustainable', rising by 200 percent during the first half of 2009, only to plummet by three-quarters between June and July. At the end of 2010, outstanding bank loans reached $US8.5 trillion, nearly a 20 percent rise on the year. (*SCMP*, 21.12.10: B3) Since there was no way that all the extra funds could have found efficient outlets, a retiring deputy governor of the central bank (PBC) warned that half of the loans might have to be written off. (*SMH*, 12.8.09: B1) The chair of the Banking Regulatory Commission puts non-performing loans (NPLs) at a mere 1.2 percent, which does not include the dubious ones yet to go belly up. (*SCMP*, 21.12.10: B3)

Despite acquiring more bad debts, mainland banks increased their profit rate by 4.7 percent in 2010. The improvements were possible because a net interest margin of three percent let banks borrow at 2.5 and lend at 5.56 percent. They make 85 percent of their revenue from interest-income accounts. With inflation above 3 percent, the depositors are losing money, which spurs a privileged few into investments or luxury spending. (*SCMP*, 21.12.10, B3) Those Chinese who could afford to purchase gold as a hedge against this welter of uncertainties sent sales of the 'barbarous relic' up from 40 metric tons in first quarter of 2010 to 45 in third quarter, valued at $186bn. (*BR*, 2.12.10: 36) Gold always returns as the currency of flight.[40]

The Banker is impressed by the size and growth of China's banks more than by their business methods or transparency:

> Ratings agency Fitch says that banks under its coverage had leverage of twenty times (equity to non-bank credits), which points to the need to raise more capital and, of course, there are concerns about asset quality, which is worrying even the sovereign analysts as revealed by a Fitch report on China released in mid-January 2010:
>
> > The weak banking system is a large contingent sovereign liability (assets to GDP are 174%). Fitch is concerned about a possible deterioration in banks' assets quality following a significant acceleration in loan growth in 2009, and the growing popularity of unreported loan transactions. Falling non-performing loans (NPL) ratios do not necessarily indicate that banks' asset quality is improving.

[40] Peter Cochrane, 'Gold: The Durability of a Barbarous Relic', *Science & Society*, 44 (4), Winter 1980-81, pp. 385-400.

> Why not? Because the balance sheet has expanded so much that, by definition, the percentage of NPLs will have fallen in line. (*The Banker*, April 2010: 106; June 2010: 68)

The bad debts from loans to local and regional governments are hidden inside shell entities with no cash flows. (*SMH*, 30.11.10: B8) Doubtful practices saturate banks in Nanking as well as in Dublin and Riga.

Take the Guangdong Development Bank, founded in 1988. It now has $US1bn in assets and is one of a dozen medium-sized lenders preparing to list on the stock exchange, with an IPO of $US4.5bn. Along with the rest of the sector, it had to be restructured in 2006 to dispose of bad debts. In the process, executives were caught taking bribes. The bank emerged with four partners, including Citigroup, each holding a fifth stake. One outcome was a tussle for control with three changes of chairman and president in four years. Despite a reduction in its non-performing loans from 2.85 to 2.4 percent during 2009, a lending splurge eroded its capital base. In July 2010, the four investors put in $US2.2bn and agreed to raise a further $US800m. in 2011. As a result of these placements, Guandong's capital adequacy ratio should go above the 11 percent required to go public, despite its shaky foundations. Once the reform package got up ahead of steam in 2003, all banks were supposed to have met capital adequacy standards by the end of 2007. The three-year lag at Guandong is as typical of the fallout from the stimulus as it is miniscule compared with the 'hidden' and uncollateralised lending to provincial governments.

The Banker examined a triad of devices in which Chinese banks engage: (a) bills of exchange, (b) opaque securitisation, and (c) loan sales. Marx's concept of 'fictitious capital' positions them within the circuits of capital.

Fictitious capital

In its strictest sense, fictitious capital is money that is not involved directly in the production of surplus value:

> The formation of a fictitious capital is called capitalisation. Every periodic income is capitalised by calculating it on the basis of the average rate of interest, as an income which would be realised by a capital loaned at this rate of interest.

The clearest instance is a bond for government debts where the interest payments come from taxation. Shares capitalised in firms that produce values are also fictitious:

> the capital does not exist twice over, once as the capital value of the ownership titles, the shares, and then again as the capital actually invested or to be invested in the enterprise in question.

Advances on unsold commodities are a third form. After the 1843 Opium War had opened China to British cotton goods, a fellow Manchester manufacturer asked Frederick Engels: 'How can we ever produce too much? We have to clothe 300 million people'. Engels later spelt out how such 'irrational exuberance' gave rise to

> the system of mass consignments to India and China against advance payments, and this soon developed into a system of consignments purely for the sake of getting advances … which led inevitably to over-flooding the markets and a crash.

For a while, the sham was kept on the high seas, as Engels explained, by advancing credit for sale before manufacture:

> The easier it is to obtain advances on unsold commodities, the more such advances are taken, and the greater the temptation to manufacture commodities, or dump already manufactured commodities in distant markets, just to obtain advances of money on them.[41]

Nowadays, a rash of credit instruments has given 'fictitious' capital as many faces as a polyhedron. China remains an immature market for the more exotic kinds.

a) Bills of exchange

Capitalism would never have been possible if all exchanges had been settled on the spot in cash. Expansion of capitals in size and reach still depends upon credit: 'Commodities are not sold for money, but for a written promise to pay for them at a certain date … Such bills of exchange circulate as means of payment until the day on which they fall due'.[42] They are discounted, that is, they are sold to raise cash for consumption, investment or speculation.[43]

The process in China today recalls the 1840s China trade but on a scale to match the current phase in the global expansion of capital:

> China's discounted bills are basically a trade finance instrument under which, if an exporter can gain a bank acceptance of his order, he can then discount the bill at either this bank or a second bank. The second bank, however, in buying the bill is taking on the risk not of the exporter but of the accepting bank which retains the corporate risk. In China this is a huge business, accounting for 23 percent of new lending in the first half of 2009, and is attractive to the banks because they can compete on price as opposed to the more regulated general lending. However, it makes analysing banks' corporate risk exposure somewhat complex. By subcontracting the discounted bills plus acceptance, Fitch estimates that China Minsheng Banking Corp's and China Merchants Bank's credit exposure grew by 48 percent and 42 percent, respectively, in the first half of 2009. (*The Banker*, June 2010: 68)

The bills of exchange are one more means for banks to elude central regulations and to conceal uncollatoralised loans.

b Securitisations

The 1995 *Princeton Review's Word Smart for Suits* defined derivatives but had no entry for securitisation. *The Banker* has obliged with an example from China:

> The securitisations involve wrapping up loans and selling them as wealth management products, giving a pick-up over deposit rates but hardly sufficient considering the risk involved … Banks say they are off balance sheet but, as with the subprime crisis, they might themselves be liable for reputational reasons should there be a problem.

Notwithstanding the risks exposed in the sub-prime, senior Chinese officials propose to securitise the doubtful loans to regional governments and the assets of the emerging industries listed on ChiNext. (*BR*, 14.10.10: 29; 23.12.10: 34)

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[41] *Capital*, III, Moscow, pp. 406-7, 465-9, 509; Penguin, pp. 533-4, 541; 595-600, 641 and 675.
[42] Thomas Tooke quoted by Marx, *Capital*, III, p. 400-1; Penguin, pp. 527.
[43] Peter Newman *et al.* (eds), *New Palgrave Dictionary of Money and Finance*, Macmillan, London, 1992, pp. 206-7 and 674-5.

c Loan sales

As with securitisations, loan sales repeat the 'originate-and-distribute model' that sent the sub-prime crisis viral:

> Information is also sparse about the growing business of loan transactions. In China, this mostly takes the form of the big nation-wide banks selling loans to the smaller city commercial banks, co-operatives and finance companies, as well as the China Savings Bank.

The ratings agency, Fitch, said in its review for 2009:

> Purchasing institutions typically pay 10 percent to 20 percent below the base interest rate for the loan and selling banks record the income in fees and commissions. Typically, selling banks continue to service the loans, collecting payments from borrowers and passing these funds on to the institutions that purchased the loans. Selling banks will sometimes enter a counter-agreement to repurchase the loan at a later date. In these instances, the loans may not appear on either the seller's or the buyer's financial statements and the loan may temporarily vanish. (*The Banker*, June 2010: 68)

This thimble-and-pea trick has exceeded the fictitious by leaving no paper trail of bonds or shares.

As happens in the developed economies, a slue of instruments is available to defraud mum-and-pop investors and the taxman:

> The common practice is that firms located in China sell goods at inflated prices to an associated firm based in a tax-heaven in order to over-report production costs, thus lowering profits in China and, hence less tax is being paid … In some extreme cases, firms located in China can intentionally incur debts from foreign traders, and transfer assets abroad to 'repay' debts.[44]

One mark of this racketeering is that 17 percent of China's FDI is in the Cayman and Virgin Islands. The metempsychosis of funds as they soar to these tax heavens is bound up with the juggling of foreign-exchange reserves in pursuit of a low exchange rate.

Currency wars

> But no one can argue that a currency war is the last thing politicians want.
> *Beijing Review*, 4 November 2010, p. 31.

No spark is more likely to start a prairie fire than a currency revaluation. To Beijing, demands to lift its exchange rate is 'scheming' on the part of the US, the EU and Japan to shift the costs of the crisis onto the developing world. Most emerging economies responded to the downturn by manipulating their currencies to maintain the volume of their exports. China fears that a world-wide currency war will fuel its liquidity and inflation, and cast it, and other emerging economies, into an 'abyss'. Chinese officials see before them the negative

[44] Christer Ljungwall and Zigian Wang, 'Why is capital flowing out of China?', *CER*, 19 (3), 2008, p. 370.

example of Brazil where an interest rate of 11 percent drove up its exchange rate by 30 percent, the fastest in the world. (*BR*, 4.11.10: 29)

Since 2005, the RMB has risen by 23 percent against the US dollar, from 8.6 to 6.6. However, in reaction to the crisis, Beijing pegged the exchange rate to the US currency for two years in order to minimise the burdens from a falling dollar. Since mid-2010, the RMB has appreciated by 3 percent to fluctuate in a band, calibrated each morning at the PBC. Hedge funds are betting on further appreciations. That upward drift is only half the story as US Treasury Secretary Geithner laid out shortly before the January visit to Washington of Chinese President Hu Jintao: 'fundamental forces that … are pushing inflation higher will bring about the necessary adjustment in exchange rates', eroding the advantages from an undervalued currency by some 10 percent annually. (*SCMP*, 15.1.11: B3) Hence, a more rapid revaluation would accelerate China's inflation and compound its loss of competitiveness thereby hurting capitals in Japan, South Korea, Taiwan and the US of A as investors, customers and suppliers.

Excess export capacity

Official economist professor Yongding pointed out that the investments from the 2008 stimulus had increased excess capacity. Any decline in exports will make that excess more obvious. The larger the GDP, he observed, the more the same fraction of over-capacity becomes a burden.

The impact is hitting steel-makers which dropped their profits by 20 percent between the first and third quarters of 2010 because of shrinking exports and 'lacklustre' domestic market. Ten of the seventy-seven largest producers reported losses of $US360m. (*BR*, 25.11.10: 37) Average sectoral profit for the year slipped to 3.5 percent, beneath the national average of 5 percent in manufacturing. Imports of iron ore slipped by 1.4 percent with prices 'out of control' because of the quarterly pricing imposed by the cartel whose price-gouging cost China $26bn or 14 percent of its trade surplus. (*BR*, 20.1.11: 29 & 37) Instead of supposing that the tax revenues out of the Pilbara will continue to expand, Australians might take note of how stock-piles of iron-ore grew from 69 to 77 million tonnes in the last two months of 2010. (*SMH*, 25.1.11: BU6) The Australian Bureau of Resource Economics predicts that crude production of 674 metric tonnes in 2011 will exceed consumption by 27m. tonnes.[45]

As EU governments reduce spending, the barriers to profit-taking will rise for Chinese-based exporters. EU cuts to salaries and benefits put a double squeeze on domestic consumption, first, through an immediate loss of spending power and, secondly, by encouraging thrift to prepare for uncertain employment and further cuts to welfare. By shrinking effective demand, the contraction of credit and welfare in the EU is recalibrating the quantum of what constitutes excess capacity. Meanwhile, the US Treasury's two rounds of quantitative easing in 2010 added a little to the effective domestic demand for Chinese goods. The US buy-ins did accelerate a devaluation of the US dollar, thereby making Chinese imports more expensive in Wal-Mart.[46] The outcome for Chinese exports is much the same in both cases, realities not lost on their leaders. (*BR*, 18.11.10: 28-29)

[45] *Australian Commodities*, 17 (4), December 2010, pp. 734-8

[46] Lower prices of Chinese imports at Wal-Mart compensated for wage repression in the US of A, *NYT*, 27.7.03: BU10.

Hot money
One resting spot for the devalued US dollars is China with its higher real interest rates:

> Figures released by the Peoples' Bank of China on November 26 showed the newly added foreign exchange reached $77.6bn in October, the highest in thirty months. But the country's trade surplus was only $27bn, and foreign direct investment was $7.66bn. Using simple truth, analysts wonder where the extra $42.8bn came from. The huge gap proves the existence of hot money in the Chinese market. (*BR*, 16.12.10: 29)

This influx presents 'a serious challenge to Chinese monetary policy', (*BR*, 23.12.10: 28) and increases talk about 'Stopping the Flood' of hot money into housing. (*BR*: 3.2.11) The authorities know that the inflow is speculative, not for the long-term. As soon as better returns are spotted elsewhere there will be rush to the exits. (*BR*, 4.11.10: 29; 16.12.10: 29; 23.12.10: 36)

A researcher on international finance at the Shanghai Academy of Social Science, Zhou Yu, laid out a cascade of consequences from the US buy-ins:

> The US monetary policies could lead to large capital inflows into emerging economies as the yields in emerging markets are much higher than those of developed countries. In turn, if those countries tolerate the dollar depreciation, their external trading conditions will take a beating. But if they interfere with their foreign-exchange markets and prevent their currencies from appreciating, their inflation risk and capital bubble will throw their economies into a financial abyss.

Finally, and supposing that the US deflation does not last for twenty years as has Japan's, Yu predicts that Washington will raise interest rates, whereupon 'the large capital outflow will likely trigger a financial crisis in emerging markets'. (*BR*, 4.11.10: 29)

Capital losses
Of immediate concern to the Chinese are losses on their funds in US accounts. Beijing launched its first sovereign wealth fund, China Investment Corp., with $200bn in 2007 in time to invest in dwindling and distressed assets. (*FT*, 18.1.11: 7) In October 2009, former chief economist at IMF, and now Harvard Professor Kenneth Rogoff, warned how much the Chinese had to lose from a falling US dollar. (*AFR*, 6.10.09: 55) They hold a fifth of US securities and lose capital every time the dollar devalues. (*BR*, 21.10.10: 36) The US has benefited from China's recycling part of its trade surplus to buy US stocks and bonds and thus keep the US over-spending on exports from China. President Hu Jintao went public in 2009 with concerns about whether their $US850bn was secure. He wanted to know how much more Chinese investors could expect to lose from the sagging dollar and stock market. No doubt, Beijing had been asking such questions since 2007. Going public meant that they had not got the assurances they needed. Should they put good money after bad?[47]

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[47] Tak-Chuen Wong, Jim Wong and Phyllis Leung, 'The foreign exchange exposure of Chinese banks', *CER*, 20 (2), 2009, pp. 174-82.

If the Chinese do not contribute to US debt, they risk losing what they have advanced already. Indeed, one reason why the US poured hundreds of billions into its financial sector was to stop the Chinese and Japanese from exiting before their assets shrank ever more. The argument runs that China's commitments are so huge that it dare not let its rival fail. The other side contends that once an exchange-rate plunge looks inevitable, the smart move will be to get out quick with whatever you can salvage. In the first half of 2010, Chinese holdings of the dollar shrank by 6 percent. Can that trickle turn into a torrent?[48] As a further straw in the wind, China resumed buying Japanese government bonds, taking a further $US3.1bn in October; they also held $US4.2bn in the Korean won. (*BR*, 16.12.10: 37; 10.2.11: 18-19)

The same dilemma shadows China's lodging a quarter of its reserve with Euro assets, which is why Beijing advanced more money to Greece, Spain and Portugal. (*AWSJ*, 7-9.1.11: 4; *BR*, 10.2.11:18-19) The Director of the China Forex Investment Research Institute takes a pessimistic view of the Euro zone, picturing it as the locus for 'the real financial crisis' that will erupt once US interest rates 'stage a sharp run-up, catching the financial markets off guard'. (*BR*, 13.1.11: 35)

Fiat currencies

The recent dollar devaluations repeat what the US did to Europe in the 1960s, a stratagem which dismantled the 1944 Bretton Woods Agreement and opened a door to the financial disturbances that have raged ever since. To investigate this sixty-five year process requires some remarks on fiat currencies.

Inside the boundaries of nation-market-states, their administrations can set the value of their paper (token) money for buying and selling. They do not need to hold volumes of gold to match the supply of cash. Thus, the national money is a fiat, the expression of political power. Foreign traders, however, do not have to accept such token money at its face value. Many tourists to Berlin recall handing over DMs for the nominal equivalent in East German scraps of paper. That money served you in the East if you could find anything to buy. On your return, no currency exchange in the West gave you one DM for an East German one. Indeed, they were likely to refuse to convert at any rate of exchange. Since the late 1960s, the US dollar has had one feature in common with the East German Mark. The difference remains that the international acceptance of the dollar is upheld by the power of the US imperium beyond its borders. The place of the greenback as the reserve currency and the capacity of Washington to exact a global *seigniorage* had never been underwritten solely by Fort Knox but also by the Pentagon and US intelligence agencies.[49] Their fiat explains why the dollar still reigns despite declines since 1971 of two-thirds against the DM/Euro and three-quarters against the Yen.[50]

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[48] R Taggart Murphy, 'A loyal retainer? Japan, capitalism and the perpetuation of American hegemony', Leo Panitch *et al* (eds), *Socialist Register 2011*, Merlin Press, London, 2010, pp. 147-73; Shalendra D Sharma, 'China as the World's Creditor and the United States as the World's Debtor', *China Perspectives*, 2010 (4), pp. 100-15.

[49] Suzanne de Brunhoff, *The State, Capital and Economic Policy*, Pluto Press, London, 1978, chapter 2, on www.surplusvalue.org.au

[50] Murphy, *Socialist Register*, 2011.

The US currency remains the core of global finances with 60 percent of the reserves in central banks held in US dollars while half of the world's cross-border trades are settled in dollars. A steep depreciation will destabilise global commerce and provoke an open trade war. Before the G20 summit in November, in an indication of both the potential chaos and the lack of a workable solution, World Bank chairman Robert Zoellick floated the idea of returning to a modified gold standard. (*FT*, 8.11.10: 1. 14 and 15)

An expert in international finances at the Chinese Academy of Social Sciences listed three possible outcomes of the current impasse. The first would be an Accord under which China agrees to a substantial appreciation, as Tokyo had done in 1985. That would damage China. The second possibility is that no one compromises and a trade war erupts, sinking everyone. The third is a managed float of the Yuan, difficult to agree on, harder to implement and uncertain in its consequences. (*BR*, 4.11.10: 29)

At the Australian School of Business, Vince Hooper, in March 2009, suggested three ways that the US could manage its debts. One, it could do nothing too serious, which remains the dominant policy. Two, it could default, or threaten to do so to force its creditors to extend their loans. Three, the Federal Reserve could print enough greenbacks to buy in all the bad debts, with the near certainty of hyper-inflation. In that case, 'The Chinese would lose out dramatically as their loans to the US would become highly deflated'. (*AFR*, 9.3.09: 63) The high risk in each alternative spotlights more than the perils facing Chinese funds in the US of A.

Throughout, Beijing has been calling for a new reserve currency.[51] Since 2009, China has signed agreements with its neighbours to conduct bits of trade in their respective currencies, thereby avoiding the costs and uncertainties of the dollar. For instance, in November, Beijing and Moscow agreed to settle a fraction of their tiny volume of commerce in Yuans and Rubles, but omitted the largest item, Chinese energy imports. (*BR*, 23.12.10: 32-33) China opened its bond market in August to foreign banks holding Yuans and in January 2011 the World Bank delivered the 'pleasant surprise' of trading $US76m. in Yuan-denominated bonds. These moves are 'symbolic', a warning to Washington, since Yuan settlements in 2010 amounted to the equivalent of $US1bn, or 0.04 percent of the $2.5 trillion trade. (*BR*, 20.1.11: 34-5)

So far, we have surveyed the economic problems that have beset China across the twenty years of its plunge down the capitalist road. We have tracked the disproportionalities that infest Beijing's efforts to ride out the latest upheaval. Now, we shall ponder one of the solutions being proposed to lift the economy above the obstacles mounting out of its success.[52]

A NEW MODEL

In the eyes of the deputy-director of the Development Research Center of the State Council, China's 'fight against the financial crisis entered its most crucial phase' only in November 2010. A new round of stimulus 'could help the economy to avert a disastrous failure, but it will never lead to a new round of sustainable

[51] McKinnon, 2005, pp. 129-63.

[52] Disproportionalities is the thread through Rudolph Hilferding's 1910 *Finance Capital*, Routledge Kegan Paul, London, 1981.

prosperity'. (*BR*, 18.11.10: 31) How the State Council proposes to secure that advance is being made public as elements of the twelfth Five-Year Plan emerge. All officials picture the Plan as make-or-break time, not merely a turning point. In the coming five years, the State Council has to marshal the political will and bureaucratic drive to enforce qualitative changes talked about over the past ten years. The decision-makers have to move beyond what they acknowledge are the 'decaying dividends' that have driven their economy: exports; a sweated labour; plunder of natural resources; and market-style reforms. (*BR*, 23.12.10: 35) The great leap from primitive accumulation will be at least as perilous as was the switch from central planning to market-Leninism. The change of course is to be set by tacking from dependence on ever more exports towards reliance on domestic demand through a Great Bourgeois Cultural Revolution that will disperse more of the benefits to nearly a billion wage-slaves and farmers.

Domestic demand
Even before the eleventh Five-Year Plan had begun in 2006, 'balanced growth' was a mantra to reduce the reliance on exports in favour of domestic demand. Once more, the State Council is intoning that the economy must surge down that path. Boosting domestic demand is more complicated than it seems from pointing to unmet needs among those Chinese yet to flourish under post-socialism. Within capitalism, demand needs to be effective, which means, first, having the cash or credit to buy, and, secondly, being possessed by a counter-Weberian spirit to spend up rather than to save.[53] The average Chinese household saves a quarter of its disposable income, three times the OECD figure. Hence, an increase in domestic sales is not just a financial issue, but requires a thought-reform programme to abandon thrift and embrace debt. The regime must convince hundreds of millions that it is in their best medium-term interest to go into debt. Installing that attitude in the United States took decades and cost billions in the marketing of consumption as a moral duty.[54]

Chatter about China's being 'Communist' epitomises the shallowness of the commentary. The Chinese nation-market-state is capitalist: labour-power is exchanged for money wages. Despite redoubts of radicalism among the seventy million Party members, the CPC has no more to do with socialism or communism than does the ALP.[55] State apparatuses are essential to the expansion of capital by organising capital and disorganising labour, whether in China or the US of A, at home and abroad.[56]

Under socialism, China recorded one of the highest levels of equality as measured by GINI co-efficients. Now, it is among the most unequal. One index of the spreading inequality was that, by 2002, 20 percent of bank depositors held 80 percent of deposits. The best-off own or are paying off two or three rental properties while tens of millions are homeless. Research by the deputy director of the Chinese Academy of Social Science, Institute of Sociology, shows 'the

[53] Li Qi and Penelope B Prime, 'Market reforms and consumption puzzles in China', *CER*, 20 (3), 2009, pp. 388-401.
[54] Daniel Horowitz, *The Morality of Spending*, Johns Hopkins University Press, Baltimore, 1985; Merle Curti, 'The Changing Concept of "Human Nature" in the Literature of American Advertising', *Business History Review*, 41 (4), Winter 1967, pp. 335-57.
[55] Richard McGregor, *The Party, the secret world of China's Communist rulers*, Harper-Collins, New York, 2010.
[56] See my *The Essence of Capitalism*, chapter one on the nation-market-state.

income gap among different classes and groups is expanding', with the result that 'people's burden on education, pension and health-care spending [are] major reasons that deter Chinese people from spending'. (*BR*, 20.1.11: 32)

Today, many Chinese are on the national average of $11 a day; a stratum are on that much per hour; and others exist on less than one dollar a day. Extreme Poverty is given as less than fifty cents a day while the poverty level is now set at $226 a year, leaving a 100 million on less than seventy cents a day. The fraction of the population in extreme poverty has fallen from 10 to 4 percent since 2000. The new Plan promises to use some of the fiscal surplus to eradicate extreme poverty by 2020. (*BR*, 13.1.11: 30-31) Doubling the daily income to a dollar is not going to sell many appliances.

One restraint on consumer spending remains the failure to compensate for the destruction of Communist-era welfare.[57] Smashing the iron rice-bowl did not create 1.3 billion capitalists, as a Prestowitz pretends, but set 'free' a billion wage-slaves.[58] The transition to capitalism reduced effective demand from the 200 millions who were turned into vagabonds. The government is attempting to lessen the impact by improving the social wage with a 10 percent increase in the pension for retired workers; the spread of pensions to a quarter of rural areas; lifting the subsidy for medical insurance to $US18 a year and raising the minimum wage by 20 percent in twenty-three provinces and cities. (*BR*, 28.10.10: 28-29)

Despite the contribution to consumer confidence from these measures, 'negative real interest rates have diminished the value of residents' deposits and wealth, making them reluctant to spend', as have increased prices for water, electricity, gas and food. (*BR*, 28.10.10: 29) In January, a lead article entitled 'Boosting Demand' acknowledged that spending was being 'dragged down by inflation as high inflation drains people's purchasing power. People's tolerance of price fluctuations has declined'. In response, the People's Bank of China promised on 4 January to 'emphasise stabilising the general level of prices in its financial macro-control, effectively manage the monetary liquidation and curb rapid price hikes'. (*BR*, 20.1.11: 32) How long will it be before one faction in the State Council frustrates these central bank efforts?

Meanwhile, contrary results flow from conflicted policy objectives. The 2008 stimulus of $US586bn brought about an18 percent increase in retail sales during first three quarters of 2010 but the controls aimed against the real-estate bubble held down spending on furniture and appliances. (*BR*, 28.10.10: 28) Nonetheless, 2010 GDP growth relied more on domestic consumption than exports as retail sales shot up by nearly a fifth. Household debts also grew with credit-card holders falling behind in their payments; during 2009, the volume of late payments increased by 45 percent to $US1.15 billion. (*BR*, 14.10.10: 28)

Effective demand

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[57] Joel Andreas, 'A Shanghai Model? On Capitalism with Chinese Characteristics', *NLR*, 65, September-October 2010, pp. 78-80.

[58] Alvin Y. So, 'The Changing Pattern of Classes and Class Conflict in China', *Journal of Contemporary Asia*, 33 (3), 2003, pp. 363-376; Chris King-Chi Chan and Pun Ngai, 'The Making of a New Working Class? A study of Collective Actions by Rural Migrant Workers in South China?', *China Quarterly*, 198, June 2009, pp. 287-303.

Marx knew that 'absolutely nothing can be explained by the relation of supply to demand' outside the ratio of profit to wages.[59] Income levels determine how much debt the Chinese can afford beyond a mortgage on their place of residence. Average incomes grew from $US293 in 1985 to $US2,000 twenty years later, and are now at $3,700, 102nd in the world according to the CIA, whereas the World Bank puts China at 86th, although with the same average. (*BR*, 21.10.10: 36) The IMF places China at 95th on $US4,300. Only fifty millions are deemed to be in the middle class, with a further 100 million aspirationals. So small a percentile of discretionary spenders limits the domestic market for durables. By late 2005, China had 300,000 millionaires measured by assets, while there were twice as many in Australia, with one Chinese in 430 against one in thirty-five here. (*BW*, 6.2.06: 46-7) Today, millionaire households in China are 0.2 percent compared with 4.1 percent in the United States. The number of Chinese millionaires sky-rocketed by 60 percent to 670, 000 during 2009, a sign of bubblenomics, not of strength in the real economy. (*BR*, 16.12.10: 37)

From 1994, the government encouraged urban tenants to buy their dwellings for no more than 15 percent of their market worth. Twelve years later, those householders owned an above average range of consumer durables. For example, in 2001, 86 percent of those city homebuyers had a refrigerator against the rest of city dwellers on 57 percent; for air conditioners, the percentages were 45 and 32.[60] The influence of privileged access to home ownership on the purchase of durables underscores how big a structural change will be necessary to drive domestic demand far enough to compensate for less reliance on exports. What policy could replicate the impact of giving houses away?

By 2002, the penetration of consumer goods saw a colour tv in almost every urban home, fridges and washing machines into four out of five, video players and air conditioners in a half, microwaves in a third and computers in a fifth. Software sales shot up from $819m. in 1995 to $3.5bn in 2001. (Hale: 40 & 44) These acquisitions in the 1990s mean that boosting demand in the cities now involves the replacement of durables, or the purchase of a car.

The stimulus package offered three spurs to vehicle sales: a tax rebate, subsidies in rural areas, and subsidies to replace older models. By 2010, China had the world's largest auto output with18m. units, up from 9.3m in 2008, with almost all sold inside China. Because these results were clearly a consequence of stimulus measures, the industry expects sales growth to slump by two-thirds in 2011. One dampener is that the Beijing has imposed limits on new license plates to cope with pollution and traffic jams,[61] providing an additional reason to promote sales beyond cities that are likely to follow the lead of the national capital. (*BR*, 13.1.11: 28-29; 20.1.11: 33)

Rural consumption

Between 1990 and 2002, rural per capita income went up by a factor of three-and-a-half, against seven times for urban residents. (*BR*, 25.9.03: 12) Average urban income is now almost $8,000, more than twice the national figure. The

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[59] Marx, *Capital*, III, pp. 181-2.

[60] Li Gan, Zhichao Yin and Wenbin Zang, 'The impact of housing reform on durables on consumption in China', *CER*, 21, Supplement, 2010, pp. S55-S64.

[61] Arrighi contends that the Chinese should have kept its bicycle culture, emulating Amsterdam, not Los Angeles, as the model for wealth without destruction, *NLR*, 56, March-April 2009, p. 85.

$US26bn programme to subsidise the purchase of 77 million domestic appliances in rural areas (*BR*, 28.10.10: 28; 13.1.11: 37) shows how much outside impetus will be needed to spread mass consumption of durable goods beyond the cities, the more so because 'rural residents are less confident and optimistic than urban residents about their future'. (*BR*, 20.1.11: 32) This resistance is a double worry because rural dwellers are the largest untapped market. To overcome these obstacles

> the Ministry of Commerce will continue subsidies for rural home appliance buyers and the home appliance replacement plan, readjust the product structure of subsidies for rural appliance buyers and increase the variety of products for the home appliance replacement plan.

In an extreme example of governing the market, the state is encouraging farmers to use bankcards and to shop online. (*BR*, 20.1.11: 33)

Mis-Management at Gome

A command to spend up requires retail outlets to effect those sales. The mass marketing of appliances provides an exemplar of how Chinese businesses operate during their long march between family-owned companies and share-holder corporations. Gome is the country's largest appliance retailer with outlets in 160 cities, as well as Hong Kong and Macao, garnering sales of some $US7bn in 2010. Founder, and one-time model capitalist and now jailbird, Huang Guangyu, did what most Chinese entrepreneurs do by putting relatives and hometown boys into 'every important position'.

A rival firm, Yongle, escaped collapsing into the grasp of Morgan Stanley by merging with Gome in July 2006. Yongle's controller, Chen Xiao, became CEO of Gome. Gome, in turn, was on the brink of disaster in early 2008 because banks refused to lend after Huang's arrest for insider trading. Chen kept Gome going with $US232m. in bonds from Bain Capital. Chen and Bain then tried to take control.

The Gome case is peculiar only in as much as the move from privately-held firm to one with large and powerful shareholders, including New York financiers, is marginalising its founder. However, the unwillingness of first-generation owners to share control is universal. Like regional officials, they are reluctant to open company boards and their books to Chinese outsiders. (*BR*, 21.10.10: 32-33) The slow pace of replacing cronies with professionals is a obstacle to effective management throughout the country, including the military and universities.

Crisis as catalyst?[62]

China has been here before. And it shall be again, and again. Indeed, its institutions have been in and out of financial turmoil since 1992. Have the scams compounded each other, with each new layer of losses hiding its predecessors from oversight? Or are the reforms advancing two steps forward and one step backward despite several standstills. As a first response to the 1997 crisis, the central government pushed up interest rates to hold down loans but the regional networks proved stronger. Although almost all bank branches closed in rural areas, provincial officials pressured local managers to lend to non-performing

[62] Andrew McIntyre (ed), *Crisis as catalyst, Asia's dynamic political economy*, Cornell, Ithaca, 2008.

companies. The State Council moved to improve the quality of loans but next year compelled banks to lend to SOEs to stimulate the economy after no export growth in 1998. The government also borrowed to recapitalise the state banks, taking over their bad loans. The IMF suspected that 50 percent of borrowers were in default and that half the loans were irremediable. A further attempt to restructure saw state banks write off $US15bn in SOE debts by 2001. Asset Management Corporations (AMCs) bought in $US170bn of bad assets by swapping debt for equity, moves which the IMF considered 'largely book-keeping transactions'. An edict in 2000 sought to reduce risk 'by making loans only against collateral' and after confirming credit worthiness.[63]

As is often the case, the tardiness of this requirement was matched by its ineffectiveness:

> Banks lent more money in the first seven months of 2003 than in all of 2002. This has prompted fears that the banks may have engaged in another round of reckless lending that will produce a fresh wave of defaults in the next several years. (*NYT*, 7.1.04: C1-2)

Indeed, they did. The looser rules meant that 20 percent of all loans at the Big Four banks were non-performing; had Western standards applied, the fraction would have been deemed 40-50 percent. (*NW*, 11.8.03: 30) By 2006, only 8.6 percent of loans were said to be non-performing. (*SCMP*, 21.12.10: 10) The AMCs were to be wound up in 2009 when any outstanding loses had to be absorbed into the national budget. By then, a new crop of bad loans was being issued to ride out the slump. In 2004, the government had expected to take ten years to clean up the mess. (*BW*, 8.3.04: 46) That schedule suggests that the purge was not halfway complete when the current crisis hit.

Two questions follow from these stop-go reforms: had the system shed most of its non-performing loans before the current upheavals?; is the regulatory environment now more effective? Both matters carry implications for how the global disruptions are being handled and for the dislocations demanded by the 'New Model' Five-Year Plan.

In pondering China's prospects, we need to distinguish the next twelve months from the period until 2016. Within those two timeframes, we can consider China's place in the world economy and then the impact of its programs on Australia. After that comes a wider and much longer perspective.

Throughout 2011, the principal global disproportionality will be between looser liquidity in the US of A and a tightening in China. Of course, policy pronouncements on the money supply are not the same as altering its size. Chinese institutions are skilled at circumventing regulations. Washington's inability to rein in Wall Street means that its quantitative easings have passed hot money around to swindlers faster than the funds could invigorate the real economy. (BR, 6.1.11: 34) The root cause of that blockage has underpinned the scramble of financial crises since 1970: too much money-capital and too few productive outlets in an era of global overcapacity. Some of that excess was shut down after 2008 but some is being bailed out.[64]

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[63] Sharma, *The Asian Financial Crisis*, 2003, pp. 274-6. The want of such criteria was not limited to China as Australians had seen with Westpac a few years earlier. Edna Carew, *Westpac, The Bank that broke the bank*, Doubleday, Sydney, 1997.

[64] Robert Brenner, *The Economics of Global Turbulence*, Verso, London, 2006, and Symposium, *New Left Review* (*NLR*), 54, November-December 2008, pp. 48-85.

Just as Australia has been cushioned from the global downturn by China's stimulus pushing up its demand for resources so we will suffer more than other OECD members from any contractions caused by the drive to hold back liquidity. A failure of that effort will increase the likelihood of ever larger bubbles bursting with graver consequences for all economies. Success will add to upward pressure on house prices in Australia as Chinese investors seek outlets for savings they are prevented from placing at home.

A crucial element in the New Model for Australia will be the oligopolising of the iron-and-steel sector to strengthen its bargaining power in price negotiations, thereby lowering the tax returns here, even if tonnages increase.

'Permanent crises do not exist'. [65]

Many of the difficulties reported here are the frictions found in any economy, and their concatenation will not derail the engine of the world. Other problems are structural. The distortions and illegalities that seem contingent on the stimulus are erupting out of deep-seated flaws. Notwithstanding, China is never going to go the way of Iceland, showing up as a quirk on global markets, a once-in-a-hundred-year volcanic event. What has been demonstrated is that China does not rule the world – militarily or economically – and is not about to do so any time soon. What is ineluctable is that China will fall into at least one ditch as it pursues 'harmonious balance'. Its next stumble will involve some 'very big numbers'. Not doing so would make Chinese capitalism unique since the closer it comes to being a market economy, the more it is subject to the business cycle – not to mention to enduring a long trough like the ones that overtook Britain between 1873 and 1893, the world in the 1930s or Japan since 1990.

Writing before 2007, the new generation Maoist Li Minqi envisaged China's growth wrecking more than the globalisation of the previous thirty years. He predicted that the era of global accumulation would last only until 2010 because of a falling dollar and Peak Oil:

> … the so-called 'rise of China' in fact reflects as well as greatly accelerates the structural crisis of the capitalist world–economy that will lead to its eventual demise. [66]

Long before that eventuality, inflation and labour unrest are challenging China's export competitiveness while the failures of developed economies are combining with the swathe of difficulties inside China to present its planners with trilemmas on how to keep going at the levels of the past twenty years. Overtaking the US is an order of magnitude beyond their scope.

Also publishing in 2007, Giovanni Arrighi took a wider view of the prospects for the Global South, focusing on international relations as much as on political economy:

> The central question … is whether, and under what conditions, the Chinese ascent, with all its shortcomings and likely future setbacks, can be taken as the harbinger of that great equality and mutual respect among peoples of European and non-European descent.[67]

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[65] Marx, *Theories of Surplus-Value*, III, p. 497n.

[66] Li Minqi, *The Rise of China and the Demise of the Capitalist World Economy*, Pluto, London, 2007, pp. xviii and 177-9.

[67] Giovanni Arrighi, *Adam Smith in Beijing, lineages of the twenty-first century*, Verso, London, 2007. p. 379.

Arrighi rightly see the rise of capitalist China as one more step in the decolonisations that began during the French Revolution, were revived by the Bolshevik and Chinese revolutions and are finding one of their expressions in the Bolivarian revolution centered on Venezuela's making loans to other Latin American nations to break from IMF and World Bank directives. The unraveling of the Cold War Middle East goes far beyond its immediate inflation of oil prices. That protracted process is the threat to the dominance of US-based capitals, not necessarily to the rule of capital.

Although Li and Arrighi both derive their analyses from Marx, Li marries ecological fears to the interests of working people whereas Arrighi gives more attention to relations among nation-market-states. As the endless accumulation that is essential for the survival of capitalism becomes ever more costly, anti-imperialist struggles and class struggles cannot be uncoupled. Economic collapse of itself will never displace the dictatorship of the bourgeoisie. On the contrary, the rule of capital will become more violent than ever, a lesson which Chinese workers understand better that those in neo-liberal democracies.

Abbreviations:
AFR *Australian Financial Review*
AWSJ *Asia Wall Street Journal*
BR *Beijing Review*
BW *Business Week*
CD *China Daily*
FT *Financial Times*
NLR *New Left Review*
NW *Nikkei Weekly*
SCMP *South China Morning Post*
SMH *Sydney Morning Herald*