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China

A Crash With Chinese Characteristics

- Debate -

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China's stock market crash was a fleeting convulsion. Its system of authoritarian capitalism is unscathed.

The Shanghai and tech-heavy Shenzhen stock markets crashed 32 percent and 40 percent, respectively, from peak (June 12) to trough (July 8), wiping out over $3.2 trillion in value â€" equivalent to the market capitalizations of France and Spain combined. The Chinese state responded with a series of extraordinary and unprecedented measures, essentially rendering it illegal for share prices to go anywhere but up. Chinese stocks obliged, and while there is still volatility, just a few weeks later the markets have recovered roughly 15 percent.

What just happened?

Perhaps we can call it a "stock market crash with Chinese characteristics," to echo Deng Xiaoping's phrase coined to describe the introduction of capitalism in China from 1978: "socialism with Chinese characteristics."

The destruction in financial value is massive, but it will not lead to the collapse of the Chinese Communist Party (CCP) â€" let alone China itself. Some Western observers never seem to lose confidence in prophesying "The Coming Collapse of China" with the CCP's every hiccup and misstep, but it is important to resist this tendency just as we must stop seeing every congressional gridlock or diplomatic embarrassment as a harbinger of the decline of the United States.

In the case of China's recent crash, there is also a sense of schadenfreude among some Western observers. This is because Chinese elites are now facing their own crisis seven years after the global financial crisis, when Chinese observers chastised Western (particularly American) elites for their highly volatile and destructive "free-market" system â€" as opposed to China's supposedly more stable state-controlled financial system.

Whether we like it or not, capitalism is the most durable, flexible, and dynamic socioeconomic system of power that has ever existed, and in this regard, so far the Chinese version is no different.

The massive $3.2 trillion destruction in financial value hasn't sparked a broader financial crisis in China â€" an illustration of how China's financial system is different from other major powers. While the People's Bank of China has sufficient firepower to reverse a crash of several trillion dollars (far more than most other countries), China's financial system is also comparatively isolated relative to both global finance and China's own domestic population. Only 6 percent of Chinese households own any stock whatsoever, compared to 55 percent in the United States.

This insulation partly explains why the Chinese stock market was less impacted, relative to neighboring countries, by both the 1997–98 East Asian financial crisis and the 2008–9 global financial crisis, and is largely the result of state policy.

The global investor class cannot buy and sell freely in the Chinese stock market, and in early July, in order to stop the free-fall, the Chinese state implemented several measures including banning corporate executives, board members, and any investor owning 5 percent or more from selling company shares over the next six months, to forcing "listed companies to report positive news to bolster stock prices." One of China's largest institutional investors, the National Social Security Fund, was ordered not to sell any shares at all, and from July 8 to July 10, trading in half of China's listed companies was suspended.

China’s developmental model, therefore, prioritizes the political stability of the CCP, or what the state calls “social stability,” over the interests of investors and shareholder value. This is one reason why use of the label “neoliberal” in reference to China tends to confuse more than clarify, since there is no liberal separation between public and private in China.

Indeed, in a similar vein to the Japanese and South Korean developmental states historically suppressing the interests of savers (i.e. the general population) to benefit capital, a primary function of the Chinese stock market is to transfer savings from the newly arrived middle classes to the state-owned enterprise sector â€” a crucial mechanism of CCP power.

State control over the stock market will not prevent financial crises in the future, and does not mean that the Chinese state easily controls the financial sector. In fact, the immediate spark of the recent crash occurred when, on June 13, Chinese regulators announced a crackdown on margin lending (the practice of borrowing money to invest in shares), which they believed was getting out of control. China’s 140 percent stock market boom from November 2014 to June 12 was dependent on margin lending.

Three weeks later, the government-induced recovery massively intensified margin lending. The People’s Bank of China and all the main SOE banks have pumped hundreds of billions of dollars into the China Securities Fund Corporation, which was founded in 2011 and is the main state-owned vehicle that lends to brokerages engaged in margin lending.

Officially sanctioned margin lending is two to one, but in the gray market it reputedly reaches five to one or more with unknown risks to the financial system. As a result, systemic risk due to margin lending is now even more dangerous than it was on June 12, and nobody knows what will happen once the state relaxes its emergency measures that are currently propping up its stock market.

The recent crash and the state’s bold interventions contribute to a broader sense of uncertainty over China’s economic trajectory. The state management of the crash suggests that China’s RMB is far from challenging the US dollar as a global reserve currency, which at minimum would require an open capital account. And recent events increase uncertainty for China’s myriad infrastructure development institutions and initiatives â€” ranging from the Asian Infrastructure Investment Bank to the Silk Road Fund â€” all of which partially depend on financing from a healthy and open domestic stock market.

At the same time, economists say the Chinese economy has substantial overcapacity in certain sectors of production and real estate, and, according to government research, roughly half of Chinese state investment between 2009 and 2013, about $6.8 trillion, was spent on “ineffective” projects. Chinese corporate debt has exploded to 160 percent of GDP (American corporate debt is second largest in the world at 68 percent), and total debt from all sources in China has rocketed from 148 percent of GDP in 2008 to 261 percent in June 2014.

But these potential tinderboxes do not necessarily spell doom for the CCP, or for China’s version of capitalism. For comparison, the Japanese stock market was the best performing in the late 1980s and became the world’s largest at the beginning of 1990, surpassing even the United States. The boom then turned to bust, falling 39 percent by the end of 1991. This led to two decades of deflation and stagnation, from which Japan has yet to fully recover.

However, while Japan is unlikely to regain its 1980s growth rates in the foreseeable future, it has not collapsed. It remains the second richest (in terms of household net worth) and second most technologically advanced country in the world. What changed from the 1980s are forecasters’ prognostications of Japan surpassing the United States to become the next economic superpower.

With the growth slowdown of China amid heightened domestic problems â€" including increasing debt, financial volatility, overcapacity, and even the possibility of a full-blown financial crisis sometime in the near future â€" observers will similarly have to adjust their expectations of continued explosive Chinese growth. This revision has implications that extend beyond China to the numerous countries that depend on exporting to China â€" especially Third World commodity exporters, but also Australia and, to a lesser extent, Canada.

But again, slowdown and the inability to decouple from, let alone surpass, the United States certainly does not equal collapse. And Japan's experience also tells us that even a Mt. Fuji of debt is not necessarily unsustainable if the financial system is relatively insular.

Japan has been able to sustain total debt near or above 200 percent of GDP for over a decade because the majority of participants in the Japanese financial system are Japanese. The same point is even truer in the case of China, since the Chinese financial system is owned and operated by the CCP â€" and not private Chinese, let alone foreign, investors.

Yet how Chinese domestic contradictions of overcapacity and over-investment will play out is anyone's guess â€" mine is that the CCP will likely muddle through â€" at the continued expense of Chinese workers, keeping a lid on their rising living standards. Indeed, the history of the United States is useful for understanding this durability-despite-exploitation.

While the 1930s labor movement was characterized by increasing unionism, mass strikes, and socialist party politics, in the decades following World War II the US working class â€" especially white males â€" was progressively atomized and co-opted.

Through the New Deal and later the 1944 GI Bill, the working class was given a sizable stake in the American pie through social spending, pensions, mortgage financing, and other forms of financing â€" from auto to credit cards to student loans. This was coupled with a culture of mass consumption and a successful campaign of smashing the unions. For many it became more beneficial to strive to join rather than rock the boat.

What American elites achieved in half a century or so China is trying to accomplish in less than two decades. Since 2012, President Xi Jinping has even introduced the concept of the "Chinese Dream," equating rising living standards with home ownership and mass consumption.

But unlike the American version emphasizing rugged individualism, the Chinese Dream also encompasses a discourse of nationalism that revolves around returning China to its great power status as the "Middle Kingdom" â€" never again allowing the so-called "Century of Humiliation" (1839–1949) in which China suffered from Western and Japanese imperialism â€" all centered on the guidance and management of the single-party state.

So while there is rightfully much excitement about increasing labor activism in China today, most campaigns and actions are, understandably, concerned with bettering workers' position within the exploitative structure of the Chinese Dream and CCP power, rather than building a movement to challenge authoritarian state capitalism itself.

This of course could change, so it's important for the Left in the United States to learn about the ongoing (and ever-changing) Chinese version of state capitalism. For example, during the global financial crisis, there were calls on the US left to nationalize the banking system in the West, with an emphasis on the relationship, and in some left circles, equivalence between nationalization and state control.

As the recent stock market crash shows so clearly, the Chinese banking system is entirely nationalized and under state control. But the Chinese financial system is not designed for the benefit of the working class, nor can China's state-directed financial system overcome high volatility or prevent market crashes.

Thus, while nationalization of the financial sector is necessary, democratization is the crucial factor to ensure the interests of working people. These interests will not be prioritized as long as the financial system is controlled by a single authoritarian party â€" as in China â€" or by private capitalist interests, as in the United States. The financial system, especially decision-making over where to direct credit, must be democratized.

In the meantime, unfortunately, given the current structure of global, and in the case of China, national financial markets, we should expect more, and probably even greater, financial crises to come.

Jacobin