

Evergrande crisis - capitalism with Chinese characteristics

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China is discovering that under capitalism, what goes up must come down. The impending collapse of property developer Evergrande, as it struggles with more than \$300bn debts, is reminiscent of the subprime mortgage crisis. The Chinese government is facing the same dilemmas as the US over a decade ago, as it stares into the abyss of capitalist crisis.

What is Evergrande?

The past decade of economic growth in China has been fuelled to a large extent by a housing construction boom. Property now makes up around 30% of GDP. For years, property developers, of which Evergrande is only the largest, borrowed unsustainable amounts of money in order to build housing. It was even borrowing from its own employees to keep building.

Another property developer, Fujian Fusheng, deployed a so-called “3691” model: start building new developments in only three months, start selling the properties in only six months (while still being built), finish construction within nine months, and return the money with interest in a year. This breakneck pace was dictated by the feverish nature of the property bubble and the large amounts of debt it had to take on in order to compete. Unsurprisingly, Fujian Fusheng has gone into default.

The entire industry was borrowing huge sums on the assumption that house prices would keep on going up. Goldman Sachs says the industry’s total debt is now \$2.8trn, or 18% of China’s GDP. But if anything should burst that bubble and property prices stagnated or fell, it was clear the debt load of property developers would sink them.

That is exactly what has happened to Evergrande. It is one of the biggest property developers internationally, and has total liabilities amounting to around **three percent of total Chinese GDP**.

Its collapse therefore threatens the world’s second biggest economy as a whole, and by extension the world economy.

Why is it collapsing? Seeing the unsustainability of this never ending debt carousel the Chinese government has placed restrictions on the amounts that companies can borrow relative to their size in an attempt to prevent a bigger collapse further down the line. However this appears to have provoked a 'hard landing' that may be spinning out of control already.

Closely related companies are folding. Fantasia Holdings, a smaller property developer, has just defaulted on its debt. Modern Land this week asked for a three-month extension on repayments on a \$250m bond. Sinic and the above-mentioned Fujian Fusheng have also defaulted.

Crisis

Home sales by value fell 17% in September, and by 19.7% in August. In some cases properties are being flogged off by developers desperate for cash with 30% discounts.

Since property makes up a massive 30 percent of China's GDP and has been the main driver of China's growth - which in turn has been the main driver of world growth - prices falling fast is a huge problem. Evergrande is not only a property company - it has a car business and many other investments. Other Chinese companies will have big investments in Evergrande. Its crisis will directly lead to crisis in other sectors.



But why has a property bubble been the main driver of the economy? Why has China seemingly repeated the behaviour in America that led to the subprime mortgage crisis?

In 2008 China actually went into recession, briefly. Millions of workers were laid off. But then in a matter of weeks the economy was growing again, thanks to the fiscal stimulus, which was so big (around \$586bn) it is widely recognised to have pulled not only China out of recession, but also the world economy out of an outright depression. But because China was by then a capitalist economy, this stimulus was delivered by means of an explosion of debt, instead of a plan of production.

If in 2008 China's private companies were holding back investment and laying off workers, there was a good reason for it, which is that there was a limit to the amount of cars, clothes and phones that the world market could absorb during the financial crisis. This problem did not go

away because the central government was lending lots of money. The “limited demand” of the crisis ridden global market remained.

Therefore if the state in its desperation drowned these companies in cheap credit, they would not use it to build bigger factories making more products they could not sell, but would spend it speculatively.

All kinds of companies, including ostensibly state owned ones, started lending the excess capital out, speculating with it, rather than investing in production. State owned steel companies created financial arms, shadow banks that would lend to property developers. These finance arms became more profitable than their core business.

As Marx explained, credit allows capital to expand beyond its natural limits, and to temporarily overcome its crisis – but at the cost of an even greater crisis when those debts have to be repaid.

As more debt is issued, it becomes less effective. It now takes around \$4 of debt to produce an extra dollar of growth in the Chinese economy, whereas before the stimulus it took around \$1.40. This is because the extra debt is largely taken on to pay off existing, unsustainable debts, instead of to spend on creating new productive capacity.

In other words, there is an avalanche of bad debt just waiting to be defaulted on. Before 2008, total Chinese debt was around 160% of GDP. By 2016, it was up to 260%.

The Chinese government funded the stimulus through debt because, in a market economy, there is no other way to stimulate growth. They could not launch a plan of production because the levers of the economy are in private hands, and are motivated by profit making and not social need.

Bursting the bubble

The fact that Evergrande could not survive without taking on more and more debt shows that it was fundamentally unsound.

In this respect, Evergrande is like a microcosm of the latent crisis of Chinese capitalism, which has only been able to keep growing by borrowing more and more money. Of the country’s fifteen biggest property developers, **only one** was in full compliance with the government’s new ‘Three Red Lines’ - the rules that make excessive borrowing harder. The problem is general and deep.

The government has introduced these measures in order to burst the credit bubble before it gets too big. The trouble is, the bubble may already be too big, and bursting it is not something the government can keep control of.

There is no evidence of a plan to bail out Evergrande. It is unclear if it can be rescued. To do so would create what they call ‘moral hazard’ - runaway debt would get even more out of control, because companies would be incentivised to take on debt to grow more quickly, as everyone would know the government would bail them out in the end too.

To bail Evergrande out is also phenomenally complex. Evergrande alone has 1.6m unfinished homes - if you add other developers in trouble, the figure is even higher. How will these homes, which have already been bought off-plan, be finished? As *The Economist* explains, “If the projects are to be kept running, local governments will probably need to take over their operation, requiring complex negotiations in hundreds of cities. Whether all this can be pulled off is far from clear.” (23.10.21)

Furthermore, rescuing a company that has been highlighted as an example of the greedy excesses of China's billionaires would seriously undermine Xi's attempt to portray himself as cutting the rich down to size and putting a stop to irresponsible economic behaviour.

If the state tried to resolve the crisis by making it easier once again to borrow more and more money, flooding the market with cheap money from the central banks, it would simply be restarting the cycle that has led to the crisis today. Just like the EU during the Eurozone crisis, China would be 'kicking the can down the road' and solving nothing. What has Europe's experience led to? Countries like Greece are as indebted as ever, so the next financial crisis will no doubt see a resurgence of all the same problems, such as the danger of the EU breaking up. And the fictitious capital that has been pumped into the economy by central banks in the West has not only merely put the day of reckoning off (and made it even worse when it comes), but it has also created a stagnant economy typified by 'zombie firms' - companies that should go bust but are kept afloat by taking on more and more government backed debt. That is China's future if they go down this path.

On the other hand, to not rescue Evergrande and allow them to default will crash the property market, leading to a Chinese financial crisis and then a full blown recession. This in turn will push many other countries into recession.

What the Evergrande crisis reveals is the limits of the capitalist system. China is reaching the end of the road for its capitalist boom, which could only be maintained with a big bubble based on fictitious capital.

Some of the leftwing supporters of the regime claim that the Chinese regime is only following a decades-long plan to use capitalism to lay the economic basis for socialism. If that was correct and the regime was genuinely communist, surely they would see this crisis as the culmination of that plan. In such a case, this crisis would be a perfect opportunity for Xi, who has more power than ever and has cultivated a left-wing image, to nationalise Evergrande and many others, beginning the transition to a planned economy. But of course this is not going to happen.

In fact, we can see the opposite shift in another recent crisis. In parts of China there have been blackouts as a result of big coal price rises. Because the government has placed caps on the amount consumers can be charged for energy, it became unprofitable for many energy producers to produce and sell energy with coal so expensive. So they simply switched their generators off, which caused sudden blackouts for millions of ordinary Chinese people. Is the government responding to these profiteering companies by nationalising them? The very opposite - they are looking into removing the energy price caps so that producers can keep on generating and selling energy at a profit even when coal prices go through the roof (*The Economist*, 23.10.21). It is working class Chinese people who will pay the price to maintain these profits.

Chinese crisis = world crisis

In 2007, the US subprime mortgage crisis sent the world economy into a deep crisis. Ironically, this crisis was prevented from turning into a depression by the Chinese starting their own property bubble, which is now leading to a crisis similar to the subprime mortgage one. The mountain of credit pumped into the Chinese economy in the wake of the 2008 crisis created Chinese demand for raw materials and capital goods, which boosted a lot of economies, such as Germany and Australia.

A crisis in China today, a highly likely scenario, could affect the world economy in a similar way as the 2008 crisis, which started in the west. Such a crisis however, would be compounded by the unsoundness of the rest of the world economy, which has never really recovered from the

financial crisis of 2008-9, and by the devastating effects of the covid pandemic. Furthermore, it would differ from the last crisis, in that there will not be another country like China to absorb the crisis internationally.

China's corporate debt is a huge 31% of global corporate debt. China's corporate debt to GDP ratio is amongst the world's highest. So a credit crunch in China will have the scale to rock world markets and spread throughout the economy.

Indeed, there is already a 'cash crunch' for some indebted Chinese companies outside the property sector, who in these uncertain times are finding they cannot borrow the money they badly need to tide them over. Evergrande itself owes billions to offshore bondholders, who will be the first to suffer from the default.

Some say the crisis in China will not seriously affect the world economy as a whole, thanks to the 'decoupling' that has recently taken place. Whilst the rise in protectionism is a very real phenomenon (and not a healthy one for capitalism), the emerging trade war between China and the US and the EU is nowhere near strong enough to have 'decoupled' the Chinese economy from that of the west. The size and centrality of the Chinese economy is far too great to allow such a separation to take place, let alone overnight.

Whilst European and American businesses will reduce investment into China due to the rise in protectionism and the fear that their investments may not be safe under Xi's regime, this will only go so far. Earlier this summer, it was reported in an annual survey by the European Chamber of Commerce that European businesses were actually increasing investment in China and moving supply chains there due to its quick recovery from the pandemic. Nearly 60% of European companies planned to expand their China operations in 2021, up from 51% last year. The most common reason given was the higher profit margins in China.

Recent events, not the least of which is Evergrande's likely default, probably mean these increased investments will not take place. But the fact that only a few months ago most European businesses were planning to increase investment into China shows there is a limit to 'decoupling' in the imperialist stage of capitalism.

This is proven by the fact that China's share of global trade is 13.6% - the biggest share of any country. It represented 28 per cent of all global growth between 2013 and 2018 — twice that of the US. There can be no doubt that the long delayed crisis of Chinese capitalism will push the world economy into crisis.

Inequality

Decades of capitalist boom have utterly transformed Chinese society. Extreme inequality is its defining feature and it dogs every thought of the regime. In January, Xi Jinping declared that "we cannot allow the gap between the rich and the poor to continue growing... We cannot permit the wealth gap to become an unbridgeable gulf."

It is comments like these that have given Xi his reputation for being a 'neo Maoist' who has a plan to abolish capitalism. But as this comment reveals, he is not opposed to the inequalities of capitalism, only its 'excesses' which are so extreme as to threaten capitalism's viability.

Whilst China now has almost as many billionaires as America (698 vs. 724), and a parliament far richer than America's (**China's top 20 businessmen-cum-lawmakers are worth a staggering \$534 billion**), on the other hand "over 28% of China's 286m migrant workers lack a toilet of their

own. And in parts of rural China, 16-27% of pupils suffer from anaemia, according to a 2016 study, because they lack vitamins and iron.” (*The Economist*, 2.10.21)

China’s inequality has grown so rapidly, that it has gone from being one of the most equal countries in the world, to one of the most unequal now, with a Gini Coefficient (a measure of economic inequality) slightly higher than the USA and Britain. China’s big cities are some of the most unaffordable places in the world.

Class consciousness is accelerated not so much by the existence of inequality itself, but by the rapid rise in inequality. It is for this reason that class anger is so high in China - there is a burning sense that the extreme wealth of the elite is unnatural and unjust, is against the communist values of the country and has been gotten by means of blatant corruption.

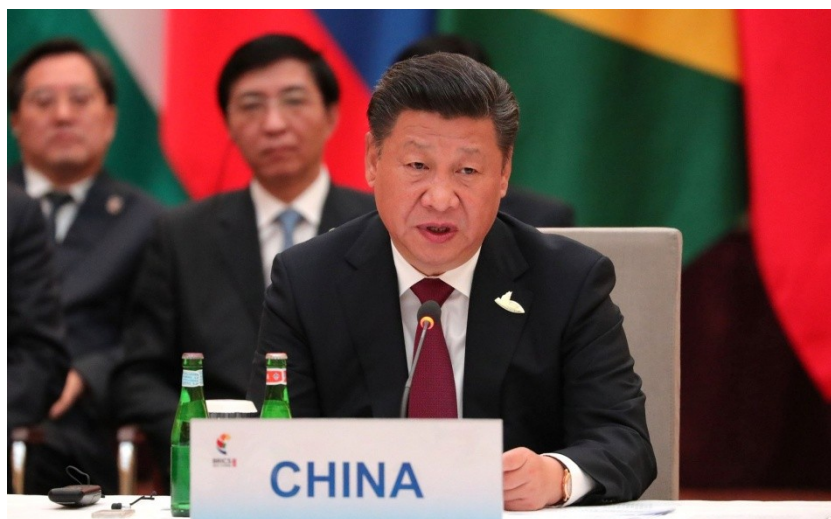
There is also profound alienation amongst China’s youth. They feel like they are running on a treadmill, unable to make any progress, and yet the booming capitalist economy has created huge pressure to succeed. This ‘treadmill’ effect is linked to the housing bubble - the economic growth that has kept people in work has also pushed up housing costs to levels completely unaffordable to the young.

Many young people see the growth of the Chinese economy not as a great patriotic success, but as someone else’s success - the corrupt rich. They are class conscious but the regime does not allow for expressions of this, although occasionally it finds a brief outlet.

Bonapartism

The regime’s awareness of this discontent is the reason for Xi’s turn to ‘the left’. He is trying to maneuver in advance of an outbreak of protests and strikes, to pre-emptively establish himself as ‘on the people’s side against the rich’. For instance, the regime has just urged Evergrande’s owner to pay off some of the company’s debt with his own fortune.

But for every attack on the rich, there is an accompanying assurance that this will not go too far. For instance “On September 6th Liu He, a deputy prime minister, tried to reassure private businesspeople, saying their endeavours were critical to the country’s economy.” (*Economist* 2.10.21)



The regime’s awareness of discontent in Chinese society is the reason for Xi’s turn to ‘the left’ / Image: kremlin.ru, Wikimedia commons

Shortly after the slogan of “common prosperity” was introduced, the party took the time to reassure the capitalist class that common prosperity **will not be achieved “by robbing the rich”**.

Capitalism was introduced to China precisely in order to preserve the power and privileges of the state bureaucracy. They did not necessarily intend to end up with full fledged capitalism, but nor did they intend on fighting for socialism. They saw capitalist investment, the profit motive, and access to advanced technology, as a means to enhance their wealth and power.

They thought they could manage this process. In a sense they have, because it has made the Chinese state very powerful.

But this seemingly all powerful regime is realising that the contradictions of capitalism are more powerful still. By conjuring capitalism into being, the regime is like the “sorcerer who is no longer able to control the powers of the nether world whom he has called up by his spells”, as Marx described in the Communist Manifesto.

The CCP is obsessed with stability. Over the past ten years, they have witnessed increasing instability in countries of the west caused by the crisis of capitalism, and they have taken note. In 2015, de Tocquville’s *The Old Regime and the Revolution* became **required reading** for high ranking party members.

Last year, Xi specifically cited Thomas Piketty’s *Capital in the 21st Century* to warn that the party must curb inequality in order to maintain stability.

Seeing the destabilising impact the 2008 economic crisis had on the West, the Chinese state bureaucracy is trying to stay ahead of the curb and ‘act responsibly’ in order to secure the stability of their system. But if you accept capitalism, you have to accept the laws of capitalism. Like all capitalist regimes, it can only maintain stability by means that increase contradictions in the long run - by issuing debt. In other words, by creating more instability in the future.

They are walking a tightrope and cannot maintain balance forever. The crisis of capitalism is catching up with China. This crisis will transform it and the world. For the past 30 years, world capitalism has been kept in business by the entry of China into the market. That is used up now. The future for China will not be like the past. The crisis in the Chinese economy is another sign we are entering an era of unprecedented turbulence and class struggle.

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