IS CHINA A CAPITALIST STATE OR NOT?
From gang master to imperialist in 40 years.

Up to the moment of collapse of the USSR, many on the left in the West characterised the economy there as being socialist. Today, some on the left charaterise the economy in China as somehow not being capitalist. In the first instance we had tragedy because the stalinists used the authority of the USSR to hammer working class communists, and in the second instance we have farce, because in China, the stalinists have encouraged the capitalists to become the new "communists".

The following observation found in that quintessential capitalist magazine, Forbes, sums up the state of economic devlopment found in China. *"The combination of numbers 60/70/80/90 are frequently used to describe the private sector's contribution to the Chinese economy: they contribute 60% of China's GDP, and are responsible for 70% of innovation, 80% of urban employment and provide 90% of new jobs. Private wealth is also responsible for 70% of investment and 90% of exports." Today, China's private sector contributes nearly two-thirds of the country's growth and nine-tenths of new jobs, according to the All-China Federation of Industry and Commerce, an official business group."* https://www.forbes.com/sites/rainerzitelmann/2019/09/30/state-capitalism-no-the-private-sector-was-and-is-the-main-driver-of-chinas-economic-growth/?sh=7fc46f6827cb The quote says it all. If we take the metropolitan areas, which I have described elsewhere, then China exhibits all the features of an advanced capitalist economy. It hosts probably the most dynamic, complex and modern metropolitan areas in the world. If it is sometimes described as a developing economy, this is due to the fact that the gap in income between these metropolitan regions and the rural hinterland is greater than that found in the West. This is primarily due to the presence and maintenance of migrant labour which has made China such a successful capitalist economy, and the disparity between town and countryside will remain as long as Chinese capitalism, particularly its export sector, depends on migrant labour.

A potted history.

China has exhibited the fastest accumulation of capital in the last three hundred years. What took other countries decades to achieve was achieved within years in China. This could never have been achieved purely on the basis of individual accumulation particularly at a time when the world economy was highly concentrated and centralised. The state, directed by the CCP, has played a crucial and undeniable role in directing and centralising this accumulation effort.

The development of the Chinese Capitalist economy can be divided into three distinct phases each with its individual dominant characteristics. Phase 1 from 1980 – 92, Phase 2 from 1992 -2005 and Phase 3 from 2005 onwards.

Phase 1. The transformation of the Chinese economy is personified by Deng Xiaoping rise to power in 1978 and the subsequent 1981 CCP resolution which set this process in motion. Phase 1 is characterised by three main factors. Firstly, the CCP now acts as gang master, supplying cheap labour to the coastal areas to encourage foreign direct investment in manufacturing This was focused on the Pearl River Delta adjacent to Hong Kong. Laws were passed providing tax advantages and joint ventures. Secondly, the encouragement of rural private production around village enterprises. Thirdly, the emergence of unofficial markets alongside the planned markets allowing for fortunes to be made arbitaging the difference in prices between planned state prices and emerging market prices. This was assisted by strengthening managerial autonomy in SOEs through the CRS system. For a history of these chanvges, see: https://reader.elsevier.com/reader/sd/pii/S1755309119300437?token=36048D91C865A30A356F93DC95C2495399F5652509EC2AC4496DA730AB6424DF49CE1ADAC15EF28F570B186DE668DABC&originRegion=eu-west-1&originCreation=20210705142241

This period is marked by the rise of inequality as capitalists begin to emerge and bureaucrats enrich themselves. It culminates in Tiananmen Square. In Comecon there were no significant and independent protests seeking to defend the old "socialist" mode of production. Tiananmen Square was not a revolt to defend the old, instead it was a revolt against the emerging new, the rise of capitalism and the inequality it was beginning to engender.

Phase 2. This period is marked by the abolition of central planning, privatisation, China becoming the globalised contract manufacturer and the emergence of a modern banking system. Central planning already undermined by growing markets is formally abandoned. The success of private production in the country side, together with the suppression of the political protests in 1989, emboldens the CCP to take the privatisation drive into the State and into the Cities. State assets are gradually privatised horizontally enriching rergional layers of the bureaucracy preventing the CCP from splintering. The state turns a blind eye to this privatisation provided the use of these assets are productively employed and are not used for personal gain or enrichment. After 1992 there is a blizzard of laws enabling privatisation including that of residential property and which sets in motion the more or less continuous property boom in the rapidly expanding Chinese cities yielding vast fortunes for property speculators and local government. For a more detailed explanation: https://theplanningmotivedotcom.files.wordpress.com/2017/03/corruption-in-china-or-back-door-privatisation-pdf.pdf This form of decentralised privatization weakened the centre which was to be corrected only with the ascension of Xi to power, whose drive to recentralise the state, was and is misinterpreted as a war against corruption. In China it can be said that nothing is what it seems.

This period also marks the emergence of China as the workshop to the world. This is concentrated in coastal cities and Hong Kong plays a major role as a conduit for foreign capital to settle in these areas. From the mid-1990s China emerges as a major global exporter. The new modern banking system is used to harvest foreign currency generated by exporters to finance the industrialisation of China.

Phase 3.

China moves from contract manufacturer to developing its own indigenous industries. These are focused on industries with lower levels of technique and I.P. and where a large market within China now exists. High Speed trains and the motor car industry being two prime examples. China continues to be plagued by the haemorrhaging of value because export prices reside well below values due to its dependency on foreign capital or licensing agreements. Thus profits are realised in destination countries not within China. According to academic studies before 2008 at least 50% of the value of exports were realised outside the country. The CCP thus sets the goal of ascending up the value chain by moving from contract manufacturing to indigenous manufacturers developing their own technology or mastering foreign technology. This ultimately brings them into conflict with US imperialism a decade later. For an evaluation of the success of Chinese independent manufacturing, please read the following report: https://theplanningmotivedotcom.files.wordpress.com/2019/07/chinas-standing-in-the-world-pdf.pdf

The CCP's recipe for success.

The ancient Chinese cooking stove had three or four legs. So too did the strategy employed by the CCP to develop their economy. It is three legs if we consider the division of the economy into upstream and downstream elements, the use of cheap labour, and the development of an export sector to provide the foreign currency with which industrialise China. It is four legs when we include the vehicle for this industrialisation, State Owned Enterprises or SOEs. In this section we will briefly deal with the first three legs and deal in greater length with SOEs in the next section.

Upstream versus downstream sectors of the economy.

Unless this division is understood, the Chinese economic model cannot be understood, nor the relationship between state and private capital. Indeed, so important is this distinction that even the CCP has had to belatedly separate out its SOE's into strategic and commercial enterprises (Stage 5) to mirror this division as we shall see later.

By upstream we understand the conversion of nature into a cradle for production. We think of power, of the provision of raw materials, of roads and railways, of communications, and so on. This provision tends to be risky and capital intensive, and often provides lowish returns, though this can be uneven - communications tend to be more profitable than roads. It is in the upstream sector where state capital is centred. In so far as this is the case, this coincides with development models found elsewhere.

What is different, is that China acquired the foreign currency needed to purchase globally, the costly means of production with which to build these cradles. Many countries were unable to do so. And despite the allegations of corruption, the CCP has done this very well, quickly and comprehensively. Today the built-assets in China exceeds by 50% (in Dollars) that existing in the USA and whereas the US had two hundred years to achieve this, in China it was done in under 50 years. Or put another way, between 2011 and 2013 China poured more concrete than the USA did in the entire 20th century which included two world wars. https://www.forbes.com/sites/niallmccarthy/2018/07/06/china-produces-more-cement-than-the-rest-of-the-world-combined-infographic/?sh=1b28c90f6881

China obtained this foreign currency by marrying up a supply of cheap labour with foreign capital in production sites on its seaboard adjacent to Hong Kong. One thing that Stalinism has always been good at, was providing Big Capital with a cheap and educated workforce. Hence the designation in the title that in the beginning the CCP were no better than gang masters organised on a massive scale. By mopping up these foreign earnings, the Peoples Bank of China created a centralised hoard of foreign currency which could be tapped by designated state enterprises to industrialise the upstream cradles.

Upstream investment contrary to popular belief was never an end in itself. It was never production for production's sake. If it was, then China could never have experienced the most rapid industrialisation experienced in the history of capitalism. And if the reader wants to be awed by this rapidity, please view the following two YouTube videos below.

https://www.youtube.com/watch?v=45Dt1Hdm39U
https://www.youtube.com/watch?v=kZCeuTzc850

Instead the purpose of the upstream cradle was to nurture downstream industries dominated by private capital which included manufacturing corporations, service (tertiary as it is called in China) corporations and real estate. Any analysis of the downstream sectors reveals a hive of competition, seething innovation, and little regulation. Until recently a truly Wild East. Truly a place where money makes money.

This is the reason that China was so easily tripped up with the computer chip embargoes introduced by Trump and maintained by Biden. China became the workshop to the world courtesy of Chinese capitalists exploiting the international division of labour with a success not found anywhere else. It was this, not reverse engineering or industrial espionage, which made China such a powerhouse. Selecting the best to manufacture or assemble products in their own name or on behalf of foreign principles led China to become the pre-eminent exporter of goods. Today China has an unrivalled technical infrastructure in its downstream sector facilitating the production of virtually any product developed on the planet and making it difficult to reroute supply chains.

Chinese corporations profited highly from this business model. But the exploitation of the international division of labour also meant that China became reliant on this division. Nothing wrong with this. Nothing wrong with picking the most cost-effective components to build products able to compete internationally. From our point of view there is nothing wrong with utilising the international division of labour. Having a single international division of labour overlapping countries makes it easier for us to build a future communist economy which by its nature must be international. It would be an unforgivable and huge waste of the labour time of society, were more than one division to emerge.

But this is exactly what Trump has forced the CCP to embark on. China is being forced to duplicate this international division of labour in the sphere of Hi Tech dominated by the USA. What happened with computer chips was both testimony to the fact that the CCP is not all knowing and all directing, and it is testimony that China lags technologically in crucial sectors. Had the "wise" CCP identified this strategic vulnerability, they could have created a parallel chip production sphere ten years ago, not designed to sell its output but to learn how to produce and innovate chips, and by gradually catching up through a high rate of redundancy, to achieve the production of use values able to compete on the open market. But while they infused funds piecemeal and made pious proclamations about the future, always a bad idea when you have no sword or shield, there was no integrated plan to achieve viability until now.

State Owned Enterprises.

In 2019 reports began to appear in the Western Press which I thought had originated in the Chinese State-owned Asset Supervision and Administration Commission (SASAC). You see it spoke about the need for corporations not to focus solely on their shareholders and profitability as Milton Friedman had directed in 1970. It declared that: "*Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country."* Then, I realised that because it had been written in English it could not have come from the Chinese SASAC. Instead it originated from the US Business Roundtable under the title: *"Statement on the Purpose of a Corporation."* Had the Chinese won? Were the CEOs of 181 of the largest corporations in the USA representing 30% of the value of publicly listed shares about to convert themselves into SOEs and learn mandarin, and this while Trump was still President. Of course they were not, and lucky for them the pandemic intervened saving them from their own embarrassments. https://hbr.org/2019/08/181-top-ceos-have-realized-companies-need-a-purpose-beyond-profit

The SOEs have been the vehicle used by the state to advance the economic interests of Chinese capitalism. SOEs have been parodied by the neo-liberals in the West. But if it was the case that SOEs act as roadblocks, misallocating and misusing resources, then how can the blistering pace of industrial development be explained in China. And no, the answer that it would have been even faster without the SOEs, is unsubstantiated nonsense unsupported by the examples of other emerging economies.

SOEs have had five iterations since there emergence in 1978.

Stage 1: Expanding SOEs' operating rights under the planned economic system (1978–1984)
Stage 2: The contract responsibility system (CRS): Separation of ownership and operating rights based on public ownership (1984–1992)
Stage 3: Establishing a modern enterprise system based on the market economy (1992–2002)
Stage 4: The reform of the state-owned assets management system (2003–2012)
Stage 5: Extensive SOE reform (2012-present) Number of SOEs reduced from 189 to 96.

It is not my intention to examine these reforms in detail. The reader can find out more by following this link which contains one of the better analysis of the 40-year history of SOEs. For a slightly different interpretation visit the second site which is useful for its observation on globalising SOEs. https://www.sciencedirect.com/science/article/pii/S1755309119300437
http://press-files.anu.edu.au/downloads/press/n4267/pdf/ch19.pdf

I will focus on three themes. The first is property rights. Up to 2002 there was an issue of senior management walking off with assets because of legal loopholes in the articles of association of these SOEs as to where ultimate ownership lay. The second was streamlining supervision and management. In 2003 the Chinese State-Owned Asset Supervision and Administration Commission (SASAC) was set up. Until then there had been no dedicated state vehicle which could act as custodian of the shares in these enterprises held by the state and orchestrate their economic functions. The newly emerged relationship between SASAC and the SOES is deftly put by the World Economic Forum. "*These efforts to make SOEs competitive while holding absolute control over their final decision-making reasserts the Chinese government's commitment to consolidating state control while simultaneously allowing the market to be the ultimate resource allocator."* In other words state companies were still required to ride two horses, market forces and state directives.
https://www.weforum.org/agenda/2019/05/why-chinas-state-owned-companies-still-have-a-key-role-to-play/

Riding two horses can be uncomfortable and tiring. The CCP sought to alleviate this predicament in the 2012 reforms. The number of major SOEs had been previously reduced by rationalisation through the agency of SASAC. Now they were to be differentiated into those considered to be commercial and those considered to be strategic, and differentiated into major which would be regulated by the SASAC, and minor which would fall under local jurisdiction. For the 8 contradictory and bureaucratic commandments under which SASAC labours, please read http://en.sasac.gov.cn/2018/07/17/c_7.htm

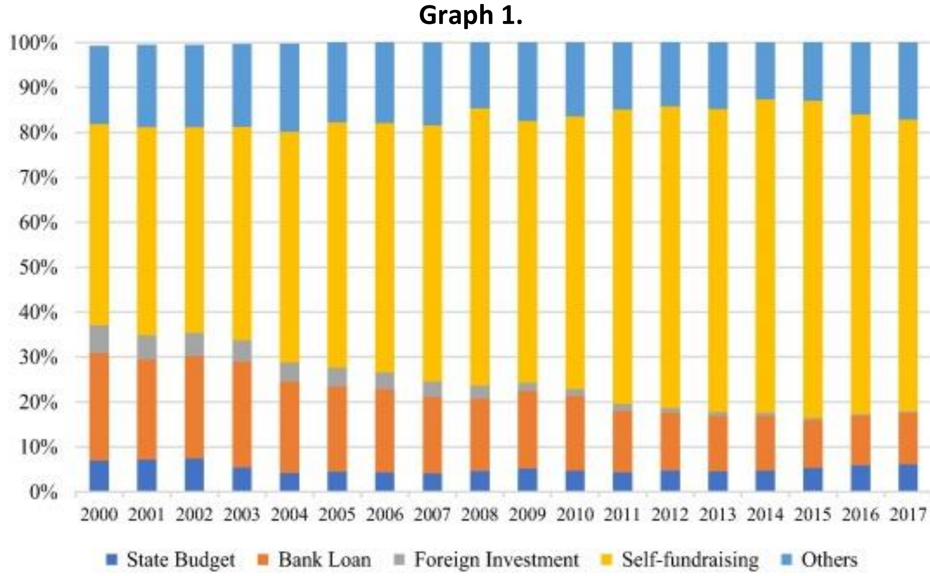
The CCP considers SOEs separate legal entities and has enacted this distinction in law. They are not considered part of the state. Thus the state cannot be enjoined in law with any particular SOE in the case of legal proceedings where for example an SOE has defaulted on a debt and the creditor is seeking damages from the state itself. This position has been tested in US courts a number of times and the Chinese panoply of laws segregating SOEs from government has been considered a reasonable defence. https://www.chinalawinsight.com/2018/09/articles/dispute-resolution/do-state-owned-enterprises-enjoy-sovereign-immunity/

Of course this is bunkum. Any competent business school teaches its students that every large organisation has both a formal and informal corporate structure and it is the latter which is the functioning one. In the case of Chinese SOEs all the senior managers are party members, and here the revolving door between working in government and working in SOEs spins faster than in the West between government and the private sector. Thus while the CCP preaches the need to act in a focused financial manner, senior managers keep one eye on government priorities, because in the end, they are careerists. They will do nothing which prejudices their standing in the party. Unlike senior managers in the West who personify the needs of capital, senior Chinese managers are ever so slightly schizophrenic.

One would not detect this from reading SOE director earnings reports. Here is an extract from the 2020 earnings report by China's biggest telecoms provider, China Mobile Communications Corporation. *"The Company attaches great importance to shareholder returns, and will maintain a stable dividend per share for the full year of 2021, after giving overall consideration to its profitability and cash flow generation." "Our equity investment returns in 2020 accounted for 11.8% of our net profit."* It could have been written in London or New York. https://www.chinamobileltd.com/en/media/press/p210325.pdf I have included the comment on investment returns because in China SOEs have abnormally large financial assets due to cross holdings.

However, he who pays the piper calls the tune. In the end when political links do not coincide with financial links, political links are put to the test.

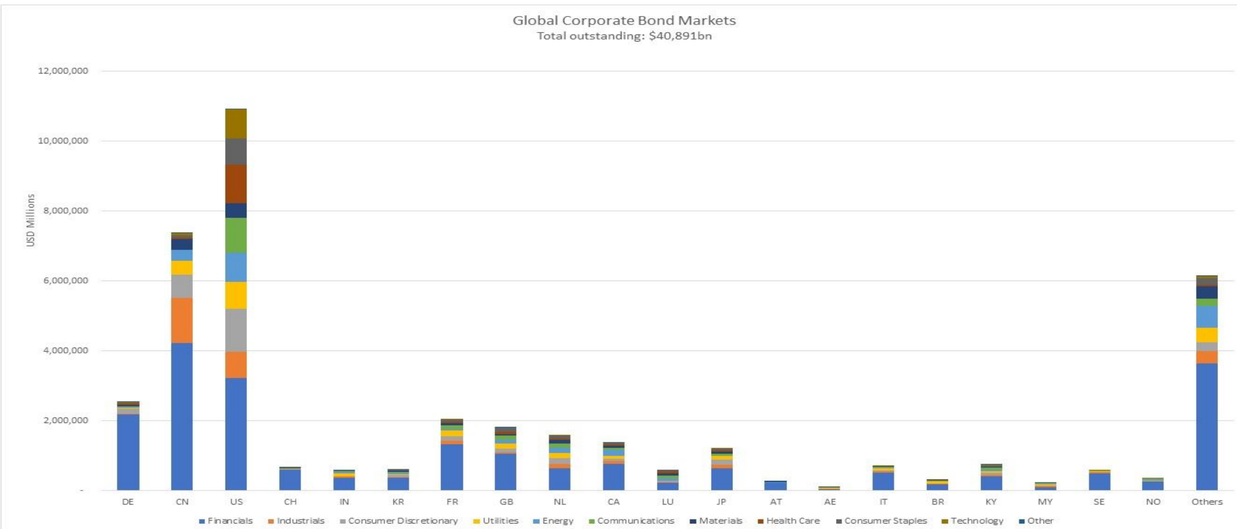
Graph 1.



In the above graph we see that SOEs now derive only a small portion of their external finances from the state. In addition foreign funding and bank loans have diminished. What has grown has been the issuance of corporate bonds. China's SOEs have become more dependent on the issuance of corporate bonds. And dependency always produces vulnerabilities. In the end when financial pressures collide with political diktats it is usually the former that prevails.

In the graph below the size of China's corporate bond sector can be seen. What is also visible is that the industrial sector is double the size found in the USA though overall China's outstanding corporate debt is smaller.

Graph 2.



https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/bond-market-size/

Although the CCP has tolerated small scale defaults, the issue of large-scale defaults is unresolved. Defaults puts SOEs in the hands of their creditors which invariably leads to restructuring which never takes any of the uneconomic priorities of the SOE into account such as job security or social stability. This issue is heightened by the growing crisis of profitability in the economy discussed at the end of the article.

Clearly the division into commercial and strategic (public) SOE's meant that the commercial SOE's would be more autonomous, and market driven, organised around maximising returns and with a growing private shareholding. *"Political rather than market logic will, therefore, remain dominant in SOEs in the public class. In contrast, increasing market competition and improving financial performance will be the priorities for SOEs designated as commercial. While all this looks like a step towards a new round of marketisation in SOEs, these documents stress that SOEs should remain party controlled."* Quoted in http://press-files.anu.edu.au/downloads/press/n4267/pdf/ch19.pdf page 362

In the same report the authors discuss the part privatisation of China Unicom the second biggest telecoms provider in China. SOEs dominate China's telecommunications industry and as this sector is highly profitable, it is ripe for listing on stock exchanges. In 2017 SASAC announced it would sell 35% of its Shanghai listed shares in China Unicom to private investors which happened to be the largest private companies such as Alibaba as well as other SOEs. This highlights the problem faced in China reminiscent of Japan in the 1980s and South Korea up to today. Shares are held by a small number of individuals or companies, and crossholdings between SOEs predominate. The free float of available shares is small which explains why Chinese IPOs are so oversubscribed due to the thirst of retail investors desperate to get their hands on shares.

In addition, one reason for the lower returns on Capital amongst SOEs relative to private companies is that their capital is inflated by financial assets, effectively crossholdings. This is reminiscent of the 1980s Japanese Keiretsu system except that these companies tended to be grouped around a major bank, whereas in China, there cross holdings are organised by SASAC. In all cases crossholdings can be beneficial during upturns, but they always become obstructive during downturns when the abrupt restructuring of corporations is required. This was the lesson at the end of the 1980s, when the nimble corporate managers in the USA allowed for the rapid restructuring of assets, whereas in Japan it took decades if at all. Clearly, the CCP whose brittle administration of society requires the protection of jobs and living standards, will even make the earlier Japanese managers appear nimble. For more on crossholdings. https://www.scmp.com/business/companies/article/1990908/cross-shareholdings-chinas-state-owned-firms-set-surge-amid-push

The key question remains; why smooth and further progress has not been achieved converting these commercial SOE's into privately listed corporation, whose windfall capital gains would be substantial for the Chinese State. The answer is two-fold. Firstly rising international tensions, and secondly and more importantly the escalating crisis of profitability in China which will be examined later. Before exploring profitability it is necessary to briefly tour the emergence of the largest SOEs as global players.

Chinese SOE's go global.

China's technological immaturity is expressed by the paucity of its international champions. China has no world leading branded champion in the car industry, the pharmaceutical industry, plane industry, software industry, household goods, consumer goods, clothing and so on. However, it does have world leaders in the energy sector, ecommerce and parts of information technology including deep learning.

Fortunately, China has another nursery in which to nurture Chinese corporations until such time they can emerge as global competitors. That nursery is the world's largest retail market for consumer goods now pulling away from the US retail market. In the 5 months to May 2021, the Chinese Market was valued at $6.5 trillion on an annualised basis while the US measured in at $6.2 trillion. In concrete terms, car sales in China exceeds that of the USA by 10 million units while smartphone sales in China pre-pandemic amounted to 407 million units compared to only 160 million units for the whole of North America (Statista). Thus setting aside exchange rates and looking at the physical size of the markets, it is likely that the Chinese retail market is 25% larger when measured by PPP, which is acceptable for this kind of market. http://www.stats.gov.cn/enGliSH/PressRelease/202106/t20210617_1818519.html
https://www.census.gov/retail/marts/www/marts_current.pdf

The *Fortune Global 500* is recognised to be the definitive guide to the largest global corporations, their growth and position. In 2020 Fortune reported that Chinese companies in terms of number now dominated the top 500 companies though not in terms of revenue. The growing number of Chinese corporations is found in the graph below. However in terms of revenue and profits US corporations continued to dominate as the Table below the graph shows. The US continued to dominate the commanding heights of the value chain especially in Hi Tech and it shows in their profit margins which exceeds that of China.

Graph 3.

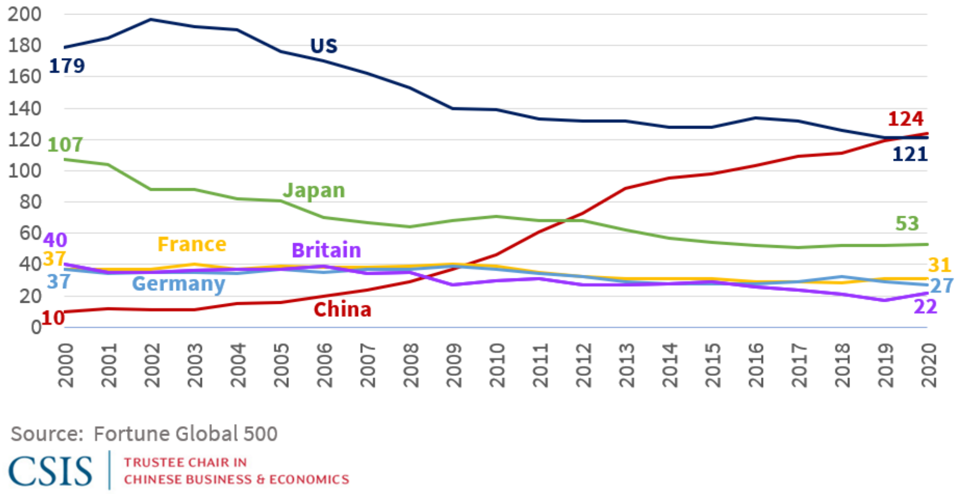


Table 1. (all figures in Billions of Dollars)

Year	USA revenue	CHINA revenue	USA profit	CHINA profit	Profit margin	Share of profit. China % USA	Growth in profit
2011	6,980	1,950	274	123	4% vs 6.3%	45%	
2015	8,560	5,840	799	305	9.3% vs 5.2%	38%	
2020	9,810	8,290	848	442	8.6% vs 5.3%	52%	309% vs 359%

https://qlik.fortune.com/global500/?_ga=2.224533210.1331072046.1625767991-1307764368.1623186857

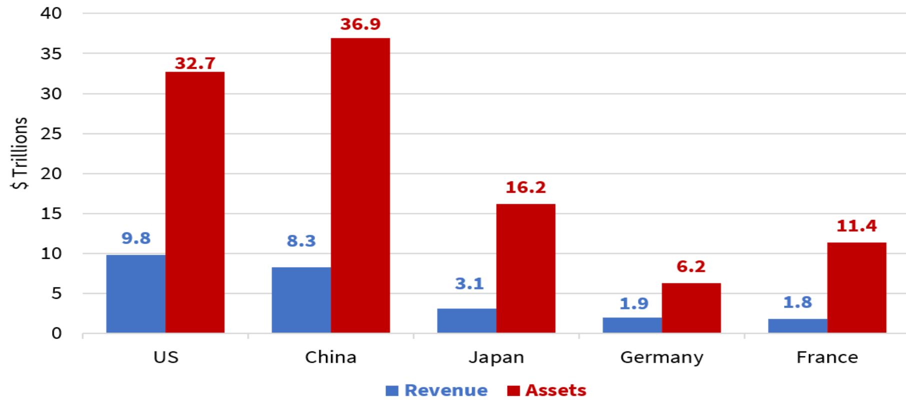
(Note: data refers to previous year, thus 2020 release is based primarily on 2019 data)

The graph shows the sharp rise in Chinese companies compared to the sharp fall in US ones. While the absolute number of Chinese firms may have overtaken the USA, and while the total gap in revenue has narrowed to within 15%, the gap in profit margins remains close to 50%. This lower profitability could be due to the fact that only 15% of the Chinese companies in the 500 are privately owned, and due to the presence of the giant Chinese banks with their huge asset bases.

It should also be remembered that China is not alone in having SOEs, even ones who are national champions. In fact the largest industrial SOE is not in China, but in Saudi Arabia – Saudi Aramco valued at over $2 trillion in 2020, and with a profit of over $88 billion in 2019 it comfortably exceeded Apple's profit. But what makes China different is the sheer concentration of its SOEs which account for 40% of output and a much larger share of debt.

Fortune provides a graph which compares revenue to assets and can be found below as Graph 4. The data there corresponds to Table 1 but includes more countries. We will examine rates of return later in the article.

Graph 4.



Source: Fortune Global 500

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To the following quote "*The primary goal of market-oriented reforms, as repeatedly reiterated by the Chinese Government, is to build a socialist market economy with the state-owned sector as a leading sector",* we could add, to build a global presence as well. In contrast to the promotion of SOEs in the global market, (Note 1.) the CCP is currently constraining if not sabotaging private corporations going multi-national by listing their shares on foreign markets especially in New York. The current example is Didi Chuxing the ride hailing App which is twice as big as Uber and as big as all its global rivals put together. After listing, shares fell by 20% after the Chinese regulator claimed to have found fault with its App. More than a coincidence given that this listing was promoted by the likes of Apple. Clearly the CCP, in the context of its rivalry with the USA, is intent in keeping its national champions in its own tent.

On a final note, Chinese SOEs are spearheading the Belt and Road Initiative (BRI). Xi likes to talk about the "community of common interest" as the philosophical justification for the BRI. Sounds awfully close to the "common weal" which was regularly used to justify the British Empire. There are a number of reasons put forward for China embarking on the BRI. First and foremost China's need to break through the military and economic encirclement of China by the USA. Thus the BRI is not just about Chinese regional economic expansion, it is also the quest of winning neighbouring countries away from being beholden to the USA. This fusion of political and economic is captured in the following quote. "*Chinese state-owned enterprises (SOEs) are the main participants in this ambitious program and are playing a leading role in implementation. As of October last year, Chinese SOEs contracted about half of BRI projects by number and more than 70% by project value. The strategic objective of the BRI is to secure a favourable international environment to facilitate China's economic development." "Chinese SOEs are given the job of supporting the state to achieve the strategic objective of the BRI. They are the main representatives of the state in China's economic diplomacy which aims to "yijing cuzheng" (use economics to promote politics) and "zhengjing jiehe" (combine politics and economics)",* [*https://www.lowyinstitute.org/the-interpreter/china-s-belt-and-road-initiative-inside-looking-out*](https://www.lowyinstitute.org/the-interpreter/china-s-belt-and-road-initiative-inside-looking-out)

The second reason has to do with internal pressures, namely over-capacity. China is the world's largest industrial economy by a long way. Over 50% of global industrial inputs, from iron ore to computer chips are consumed in China both for internal consumption and export. China's fixed investment annual growth rate within the country fell from >25% to <5% between 2010 to 2019, sharply decreasing the global rate of investment and slowing down the entire world economy. It also acted as a brake on productive industrial consumption in China. Many analysts point out that the BRI serves as the repository for China's excess industrial capacity which amounts to the entire industrial capacity of Japan. Some even claim to have received evidence of this from the horses own mouth, in this case the release of Chinese government papers by the Epoch Times. https://www.theepochtimes.com/exclusive-beijing-moves-out-excess-industrial-capacity-to-bri-countries_3541638.html Clearly there is much scope. The Asian Development bank estimates the immediate region requires £26 trillion in infrastructural investments. https://chinapower.csis.org/china-belt-and-road-initiative/

For an analysis of the content and direction of BRI analysis view this PDF. https://green-bri.org/wp-content/uploads/2021/01/China-BRI-Investment-Report-2020.pdf It shows that Chinese BRI investment was 250% bigger than China's other foreign investments, and it shows that despite the growth of the BRI, global foreign direct fixed investment actually fell from its peak in 2015.

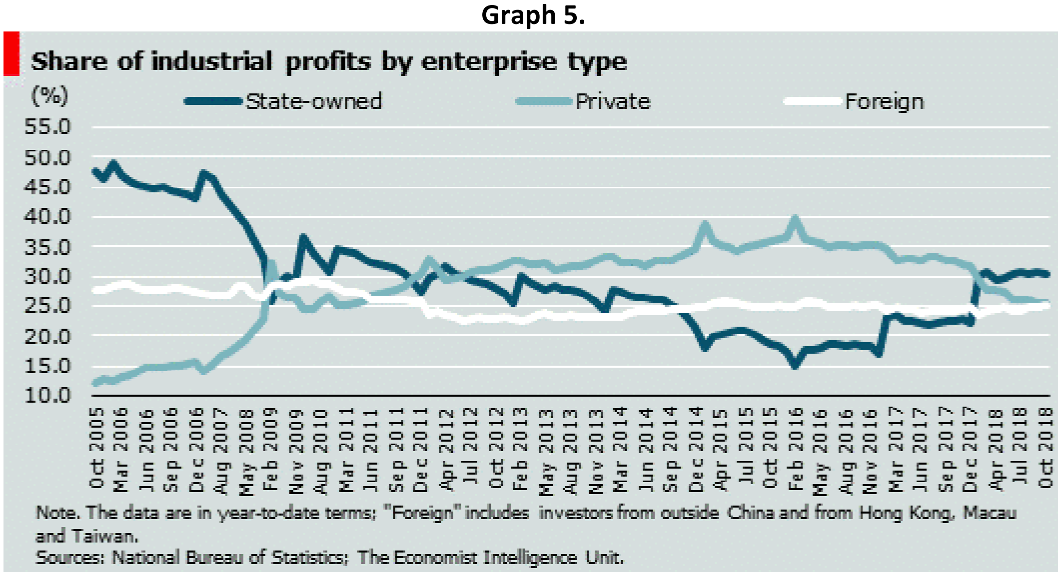
The BRI has two tracks, appropriate for an Initiative that contains the word Rail. Firstly, investing in lower waged countries to render China's excess capacity profitable, and secondly to create a common trading area reaching as far as Europe in which the Yuan can function as a major currency. This will create an expanded trading region centred on China from which the USA will be gradually squeezed out. It also has profound consequences for that strategic hot spot - the Middle East and Israel.

The crisis of profitability.

Profitability in a capitalist society can be compared to the Old Testament God *Yahweh* who is demanding, unforgiving, relentless, vengeful and who is liable to smite down anyone who dares to disregard him. The CCP is beginning to learn this lesson. Profitability in China has collapsed, and Xi's gang of one is finding that it is reshaping his world, narrowing his horizons, and depriving him of options. It is hell to ride the profit motive and reciting Marx certainly does not reduce the saddle rash.

Much has been said about the Chinese state squeezing the private sector recently. This dirge is mainly heard from those who previously saw easy pickings in China. So let us be clear. The state sector has never compressed the private sector but allowed it to flourish to achieve its sacred mission – the enrichment of the senior cadre of the CCP and their merry band of billionaires. The state has only acted when the private sector itself has been stressed and then only to make good the contraction of the private sector.

Graph 5.

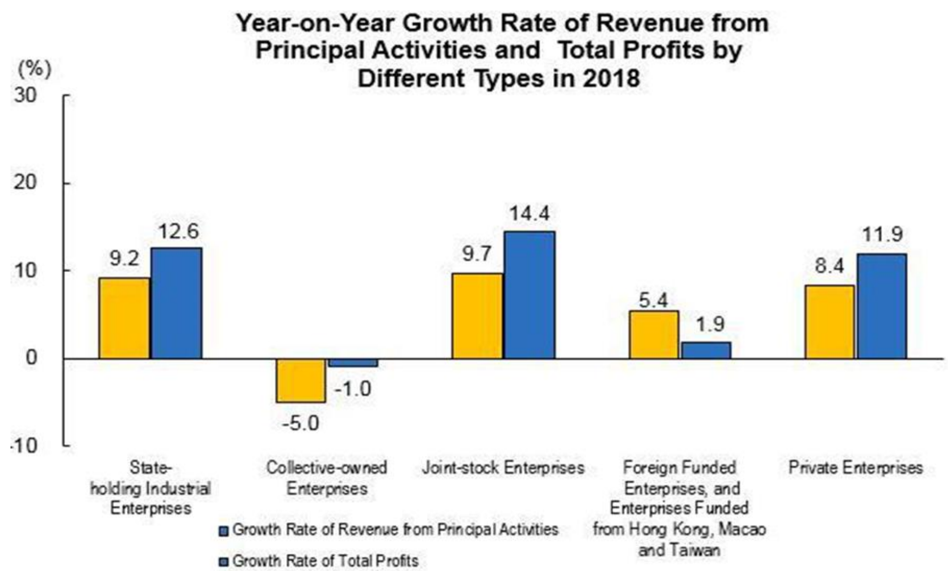


Note. The data are in year-to-date terms; "Foreign" includes investors from outside China and from Hong Kong, Macau and Taiwan.
Sources: National Bureau of Statistics; The Economist Intelligence Unit.

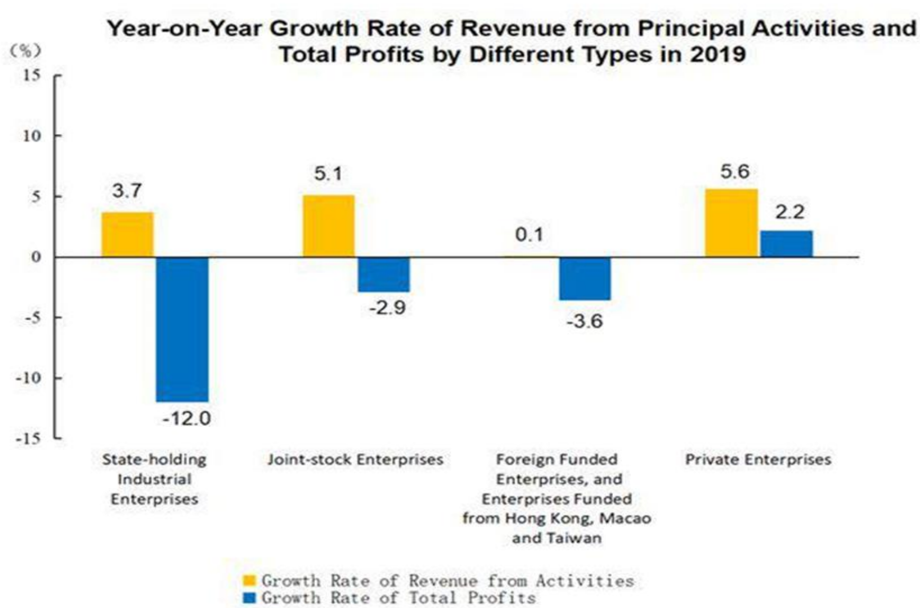
In the above graph we detect the fall in the profits falling to private companies from 40% to under 30% in 2018. Since 2016 the share of profits going to state corporations has doubled from 15% to 30%. And it is during this time that it appears that the squeeze has been put on private companies, when instead the rise in the state's sector is the result of the fall in the mass of profits emanating from the private sector.

Since 2018 there has been a slight recovery in the share of profits falling to the private sector due to the support from the state sector and latterly the pandemic and its resulting boom in exports.

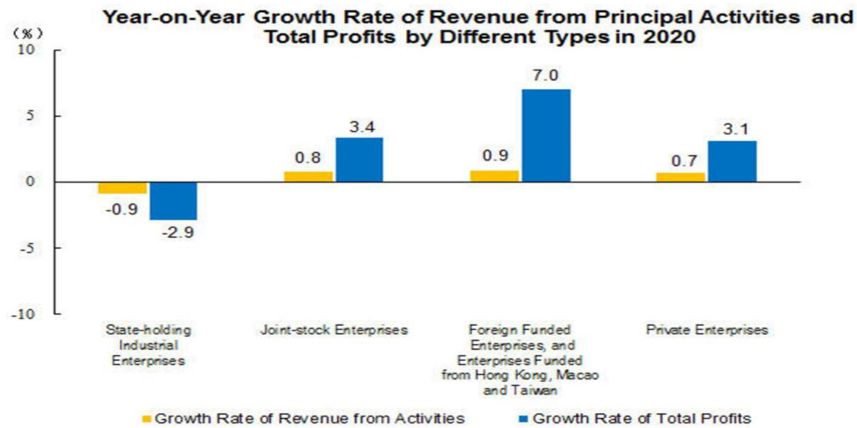
Graph 6. (Annual rise in profit +10.8%)



Graph 7. (Annual decrease in profits -3.3%)

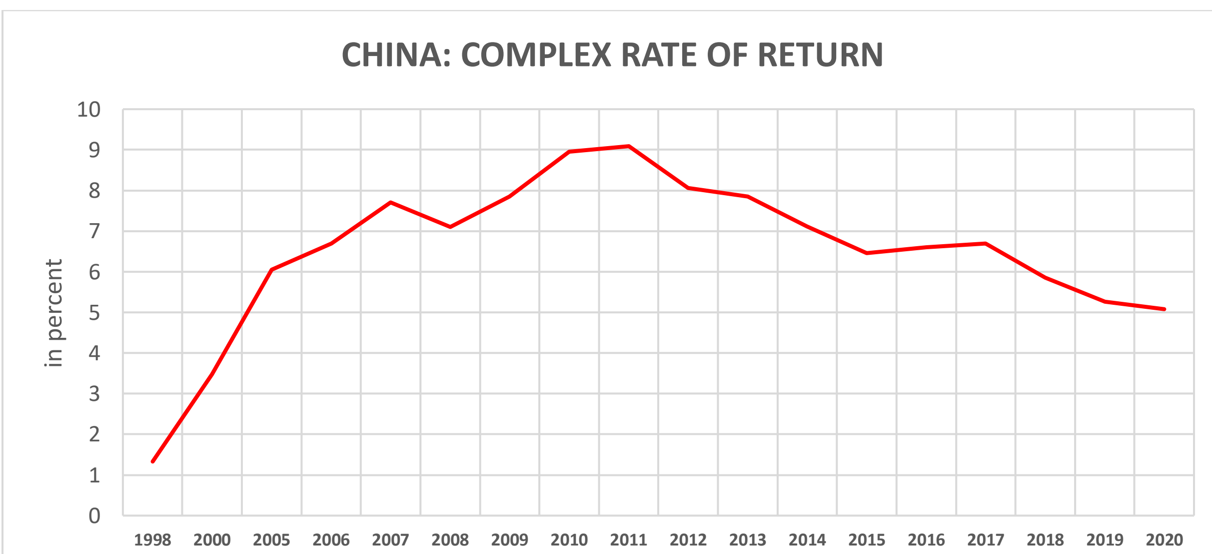


Graph 8. (Annual rise in profit 4.1%)



Total industrial profits over the three years increased by 11.6% compared to a 15% rise in GDP (pandemic notwithstanding). Not a credible performance. Within this total, state sector profits fell by 2.6%. Of course the rise in the mass of profits may not support a rise in the rate of profit, it all depends on investment. And in this case the rate of investment did increase faster than this incremental rise in profits resulting in the contraction of China's rate of return. It has fallen in 7 out of the last 9 years to around 5%. On an unadjusted basis this is not dissimilar to the movement of the US non-financial corporate rate.

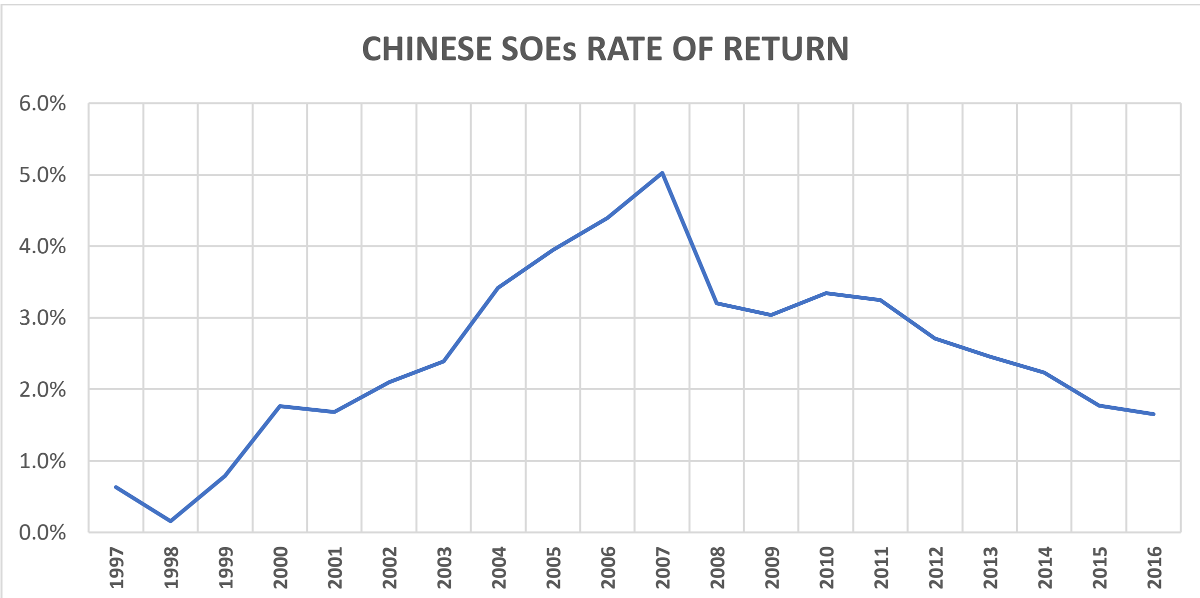
Graph 9.



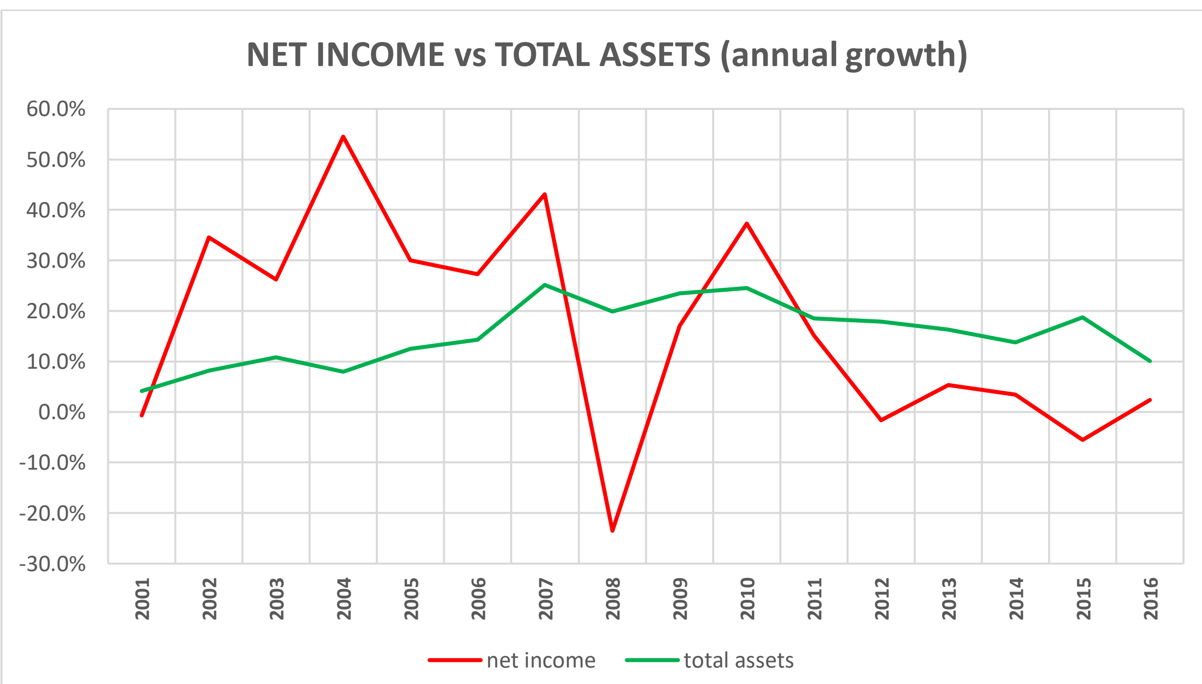
It would be a mistake to assume that this is due solely to the performance of the SOEs. In 2019, the after-tax rate of return for the top 500 private companies was just 3.76%. (1.39 trillion Y profit divided by assets of 36.96 trillion Y) This return at the time was below the cost of capital measured by the 4.25% PBC prime rate. Bear in mind the top 500 private companies are likely to have above average returns. https://www.tellerreport.com/business/2020-09-11-2020-china-s-top-500-private-enterprises-released-the-entry-threshold-to-reach-20-204-billion-yuan.r1-zXrsOVP.html

If we examine the rate of return for SOEs it is clearly below the average because of the density of financial assets and other issues. Here the rate of return is just half that of the average for the industry. Whereas there has been virtually no growth in profits (Graph 11), investment has continued to grow. A clear case of overaccumulation. Although the data set on which the graphs are based, ended in 2016, the graphs above show further deterioration up to 2019.

Graph 10.

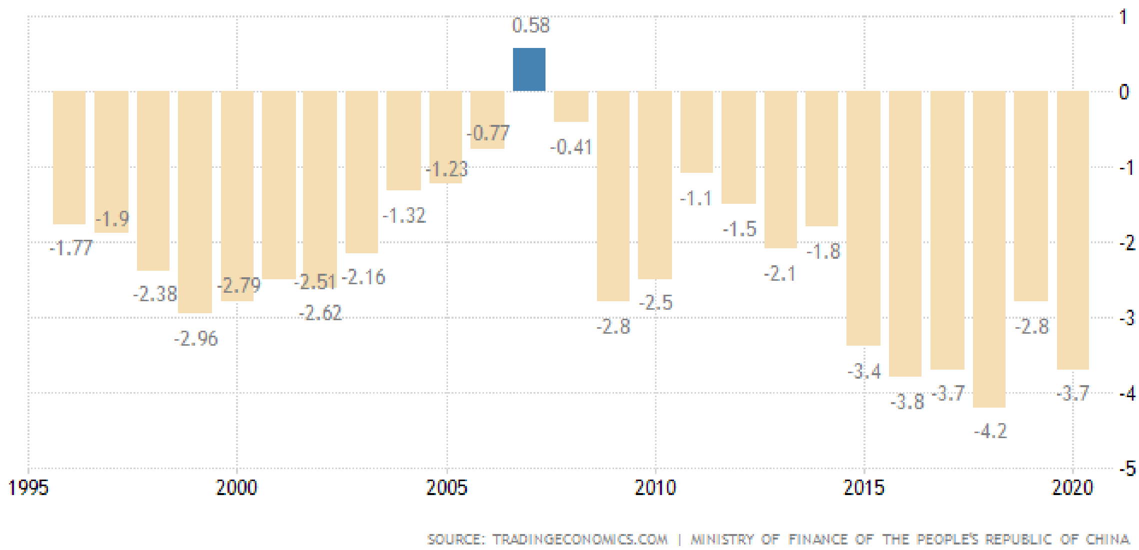


Graph 11.



On the financial and tax side, the People's Bank of China and the state use the usual methods found in all advanced capitalist countries to try and stimulate the economy. The central state does not simply throw money at the economy through fiscal stimuli. Its fiscal deficits as shown in the graph below have been no worse than those found in the advanced capitalist economies bar Germany. (We also saw earlier that SOEs rely on only small amounts of state aid for their financing.) However, what is true for the central government may not apply to the heavily indebted regional governments. But again, regional governments as in the USA are often more indebted than central governments and they do default.

Graph 12.



In 2019 when the economy was slowing sharply, the government cut the VAT rate on manufactured goods, the Peoples Bank of China reduced the reserve requirements to release more funds into the economy, and it introduced new lending instruments making it easier for companies to borrow from the banks. In many respects the Chinese banking system as a modern banking system is using the same policy tools found in advanced capitalist countries. While it is true that state banks favour state corporations, this could be more to do with banks being able to assess risk more accurately in larger corporations compared to smaller and when it comes to China, more mobile, firms.

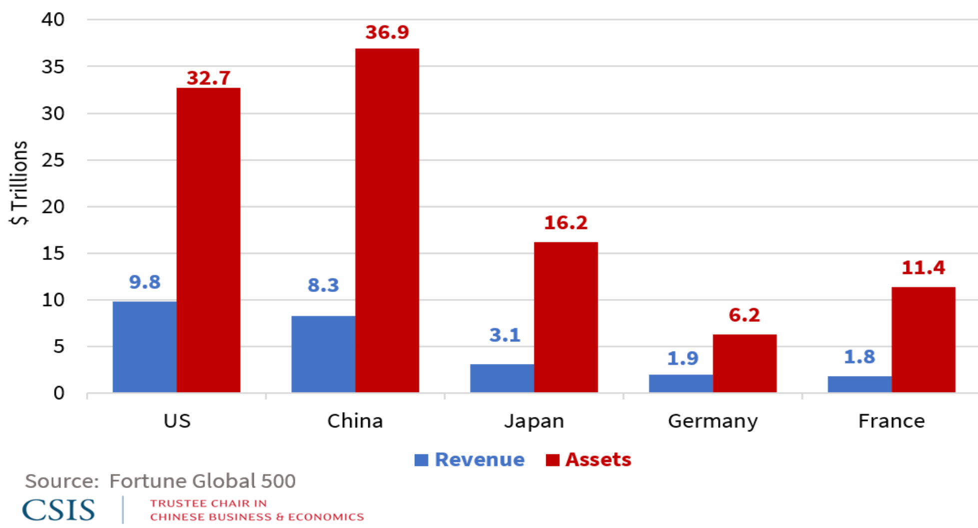
In addition, like all advanced capitalist economies China has a large grey banking system driven by the low returns from regular saving products offered by the regular banking system. Here the only difference is that the Chinese authorities are more alert to problems and act more swiftly than their counterparts in the West. Contrary to popular perception that the Chinese banking system ignores private companies and households, one has to only look at the very sharp increase in household debt and borrowing to show this not to be true. Between 2013 and 2019 household debt virtually doubled to 52.6% in terms of GDP.

In China money is money. It is able to be converted into capital or consumed as revenue. And China has developed the most sophisticated mechanisms to circulate it. China leads the world today in the use of electronic wallets and has launched the first state backed digital currency. None of this would be possible had China not been an economy based on money, therefore, on commodity production. In China generalised commodity production prevails whether these emerge from private or SOE gates.

Finally how does China stack up internationally on the profitability field at the level of their largest corporations. Once again the data below is drawn from the S&P 500. The answer is not very well.

In terms of revenue, the largest Chinese corporations manifest a higher composition of capital using the proxy measure of assets to revenue. Once again caution is advised because of the higher preponderance of bank assets in the Chinese compliment.

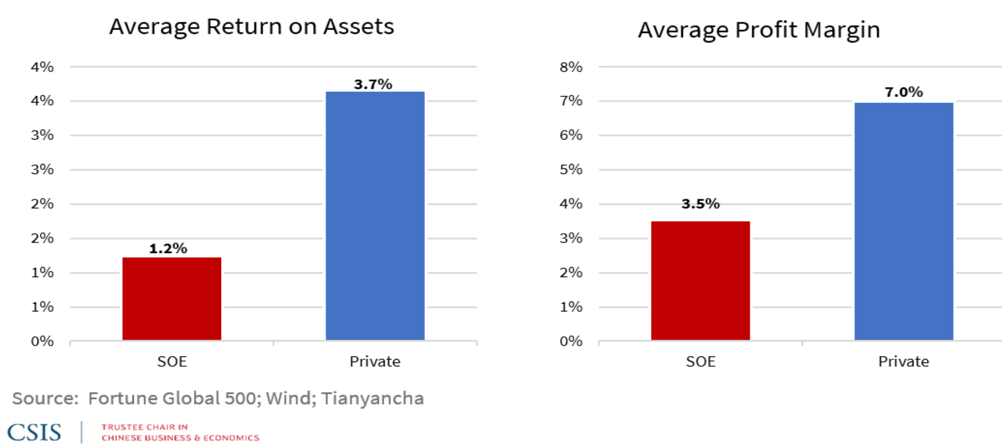
Graph 13.



https://www.csis.org/blogs/trustee-china-hand/biggest-not-strongest-chinas-place-fortune-global-500

Predictably this gives a lower rate of return.

Graph 14.



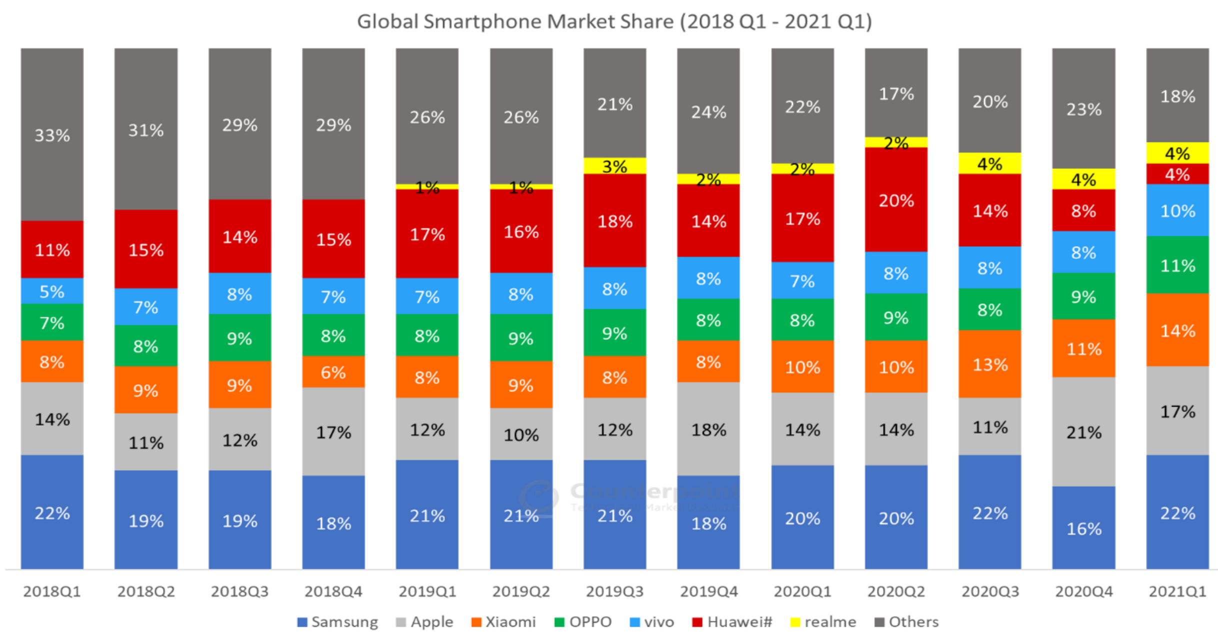
"Their (China's) profit margin (profits/revenue) in 2020 was 4.5%, just slightly ahead of France (4.3%), but much lower than firms from Switzerland (8.3%), the US (8.9%) and Canada (9.1%). The story is even worse for return on assets (ROA). China's 124 listed companies averaged an ROA of 1.9%, still just ahead of France (1.7%), but once again substantially behind Switzerland (4.2%) and the US, which led at 4.9%." (cited by the Trustee Chair in Chinese Business & Economics.)

In closing this section, while the large US non-financial corporations may straddle and monopolise the summit of the value chain generating huge profits, when viewed across the economy as a whole, and adjusting for the difference in measurement, the rate of profit is higher in China than in the USA. This is due to the fact that the average composition of capital in industry remains lower in China.

Conclusion.

China is a unique major economy. Its rapid rise within a technologically advanced world economy has left it lagging behind its competitors measured qualitatively. Its vulnerability to retaliation by the hegemonic imperialist power – the USA – can be seen in the graph below. Despite being the largest smartphone market, and despite growing nationalism in China, the temporary damage done to Huawei can be seen in the final graph below.

Graph 15.



Huawei which tied with Samsung in 2020 Q2 as the largest vendor of smartphones in the world, saw its market share fall fivefold a year later due to the Trump administration embargoes of chips and software. China is an incipient but defensive imperialist power. It is still held back by its technological immaturity. This year it rolls out 28 nm scaled up chip production, and 14 nm next year, while masking out 7 nm. It has developed a precision laser that may evolve beyond EUV etching. It is building its first jet liner with advanced parts provided by foreign vendors including the engines. It is not in a position to resolve its crisis of profitability at the expense of its competitors except in lower value production. (see Note 1.)

Nonetheless its potential to become the dominant capitalist economy is feared by the declining USA. Unlike China, the USA can resolve its crisis of profitability at the expense of China. Apple only became the world's first $2 trillion company because Trump crushed Huawei. The threat this decade will not come from China but from the USA. Thus all the attention of the international working class should be devoted to restraining the USA.

What unites China and the rest of the capitalist world is the unremitting profitability crisis. The world economy turned between 2012 and 2014 when rising profitability gave way to declining profitability and loan capital switched from focusing on productive non-financial investments to unproductive financial investments by 2016. Since then China has wobbled on the edge of a recession in both 2015 and 2019 despite the colourful GDP data.

China in common with all the other major economies continues to suffer from a chronic overaccumulation of capital, which has been only partially pared down by government aid. It is this overaccumulation that puts debt at risk. In addition, it relies on the same monetary accommodations as is found in the West. In this sense its growth, like that in the West, is unhealthy. It is this common capitalist affliction that binds China at the hip with the rest of the world.

Of course Chinese capitalism has peculiar "Chinese Characteristics" both economic and political and they interfere with each other. Out of necessity China's late entry into the global market and its technological dependency made a large state sector necessary. Out of necessity China needs to maintain the rule of the CCP to ensure political stability. To abandon the Party's iron rule would free the working class to give expression to its own needs and vent its anger at all the princelings who have enriched themselves at their expense. It is a case of the parent, the CCP having given birth to a child that towers over it and frightens it, the hundred millioned Chinese working class.

The block on reforming the Chinese state has made capitalist rule brittle in the country, which means the CCP has had to adopt a more supportive role. It is not free to rationalise the economy and cull all the unprofitable assets that is constipating its economic metabolism. It is this observation, rather than the category imperialist, that is the more important. In this area the USA has the advantage as it did over Japan in the late 1980s.

But I am of the opinion that though the Western economies are better placed to purge capital, they too are in thrall to their workers, they too fear arousing the huge working classes of this world. In order to sidestep the class struggle they have created and fed a financial monster that could devour them. This time round China is not in a position as it was in 2008 to re-float the capitalist ship. Instead, it is likely to succumb to a global recession making the CCP regret they are running an economy which will smite them down should they ignore its commandments.

A recession in China will force the CCP to respond to it as capitalists. They have no choice. If they refuse, then Chinese capitalism will stagnate precipitating an eventual political crisis. If they do respond as capitalists they will precipitate immediate political turmoil but create the eventual opportunity for further economic growth. They really have a Hobsons choice.

Brian Green 9th July 2021.

Note 1.
"Chinese state-owned enterprises (SOEs) are the main participants in this ambitious program and are playing a leading role in implementation. As of October last year, Chinese SOEs contracted about half of BRI projects by number and more than 70% by project value. So understanding the BRI from the perspective of SEOs is useful. Another widely acknowledged motive of China is to send the excess industrial capacity of SEOs offshore. SOEs will benefit from the BRI to sharpen their competitive edge in the global market. *https://www.lowyinstitute.org/the-interpreter/china-s-belt-and-road-initiative-inside-looking-out* ". Translating the word "competitive edge" means these SOEs are acting as colonialists bearing down on the locals which has led to a number of protests.