THE VIRUS THAT BROKE THE CAMEL'S BACK.

The economic difference between the current coronavirus and SARS (end of 2002) is this. In 2002 China was on the ascendancy whereas today the opposite is happening, China is in the descendancy. China is the heart of the world economy, and should this virus tip the economy into recession, it will provoke a global recession making a financial crash impossible to avoid.

The question needed to be asked, is why is China prone to such outbreaks? The answer lies in the in the specific mode of capitalist exploitation found in that country. The Chinese miracle was built on the backs of migrant labour. Chinese internal migration of around 290 million (Statista 2018) equals the total number of international migrants in 2017. (https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_652001.pdf)

This very significant number of migrant workers has three effects. Firstly, it impoverishes the countryside which is bled to support these migrants and thus their low pay. Secondly, it leads to very high urban density in those areas where migrants are concentrated i.e. dormitory type housing. Thirdly, because of the continued connection to the countryside, rural practises are transposed to the cities. Thus we find, because of rural poverty, close proximity between humans and animals. We also find "rural type" live animal markets in the cities themselves. Finally, the density of humans in this part of the city acts as a conveyor belt for transmitting viruses which feast on overcrowding, making it probable that one of the functions of a virus is to inhibit overcrowding and thus prevent ecological disorder.

These outbreaks are thus the price the world pays for cheap manufactured goods from China.

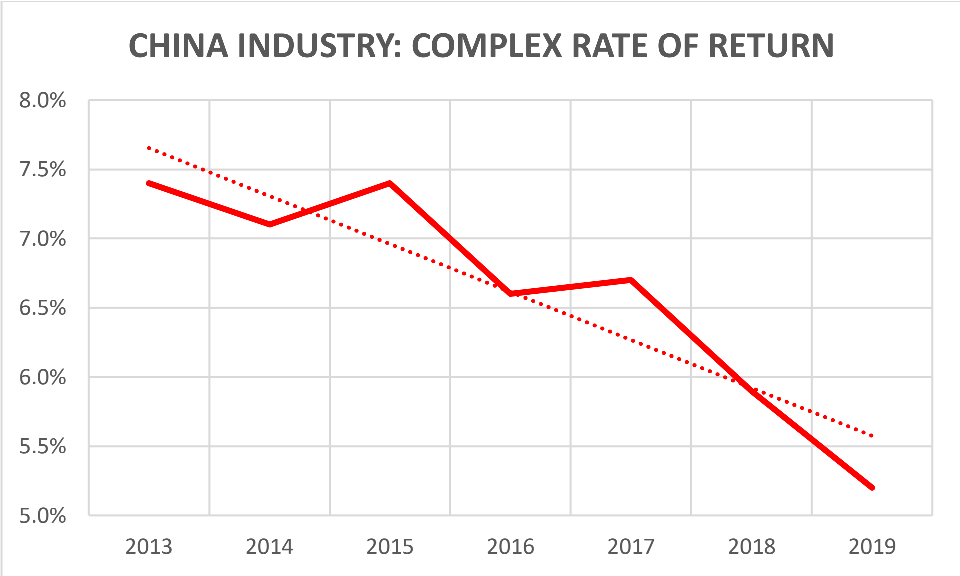
On the other hand the libertarian right will have none of this. The libertarian right is unable to calculate risk, which makes them paranoid and prone to conspiracy theories. Its mental. They characterise this coronavirus as having been weaponised in a laboratory . There are three things wrong with this theory. Firstly, weaponizing a virus is a bit like trying to peel a tomato with an axe. More likely than not you will lose your hand before the tomato is peeled. Secondly, this particular virus is not exceptionally lethal. According to the US CDC the mortality rate for seasonal influenza of people hospitalised is 0.75% compared to the 2.5% rate currently for the corona virus. But seasonal flu is much more communicable resulting in a daily winter death rate of around 3,000. This is six times the number of deaths to date for the corona virus, though admittedly this could be early days. Thirdly, it is not a robust virus and its half life outside the body is quite short. It makes it suitable for a weapon only in very dense places, and it is of interest that the density per square kilometre in China is 425% greater than the USA. So if China was the one making a weapon, it was going to shoot itself in the foot.

Chinese profitability continues to fall.

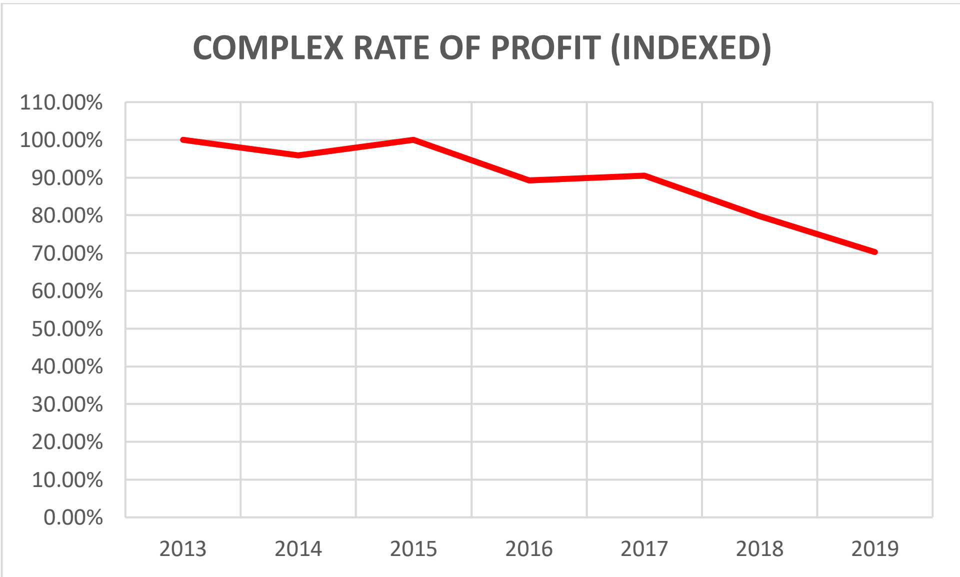
On the 3rd February the National Bureau of Statistics of China released the data on industrial profits for December and the year. Profits fell 6.3% and 3.3% respectively. This fall in profits mirrors that of the USA. Thus the world's two biggest economies are in a profit recession alongside the other major economies. (I have posted this report as a PDF alongside this article.).

This fall in the mass of profits has predictably led to a fall in the complex rate of return in China as well. The extent of the fall can be seen in the graphs below. 2013 marked peak return, and since then as Graph 2 shows, it has fallen by 30%. (Note 1.) This compares to the 25% fall in the rate of profit in the USA for non-financial corporate and 40% for manufacturing.

Graph 1.



Graph 2.

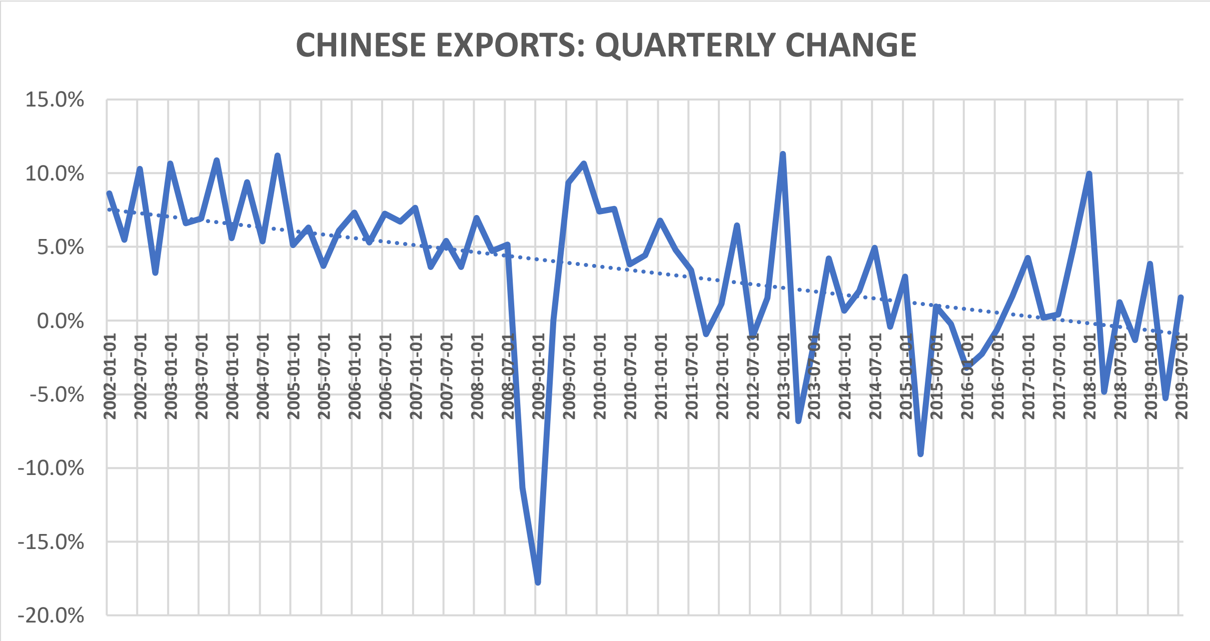


The fall in the complex rate of return to 5.2% compares to the US non-financial corporate rate of profit of 4.5%. (As Note 1 shows, these two rates are not strictly comparable. The Chinese Rate of Profit on the same measure is likely to be around 7% currently.) What is most interesting is the coincidence in the respective fall in the rates, both in terms of the starting point and severity. Clearly something structurally has changed in the world economy for these falls to take place in a synchronised manner, which may have nothing to do with the equalisation process in the rate of profit.

This is further confirmed by another indicator, the rate of turnover. Both countries have experienced a similar deceleration in turnover. The Chinese Bureau of Statistics provides essential data to calculate turnover as can be seen in the highlighted release which accompanies this article. Using that data the annual rate of turnover fell to 5.17 in 2019 from 5.65 in 2018. This is far removed from the rate of turnover of over 6 in 2015. In addition, a fall of such magnitude in turnover must impact profits.

A final consideration is global trade. China is at the epicentre of global trade. Graph 3 below shows that the growth rate for Chinese exports has more or less collapsed. The trend line shows that, whereas, quarterly trade grew by +5% prior to the financial crash in 2008, it is now trending to 0%. This is one of the major reasons that global trade has stagnated over the last two years. "*World trade momentum was -0.2% (non-annualised; 0.3% in October, unchanged from initial estimate).* [*https://www.cpb.nl/en/worldtrademonitor*](https://www.cpb.nl/en/worldtrademonitor)

Graph 3.



(Source: FRED Table XTEXVA01CNM667S)

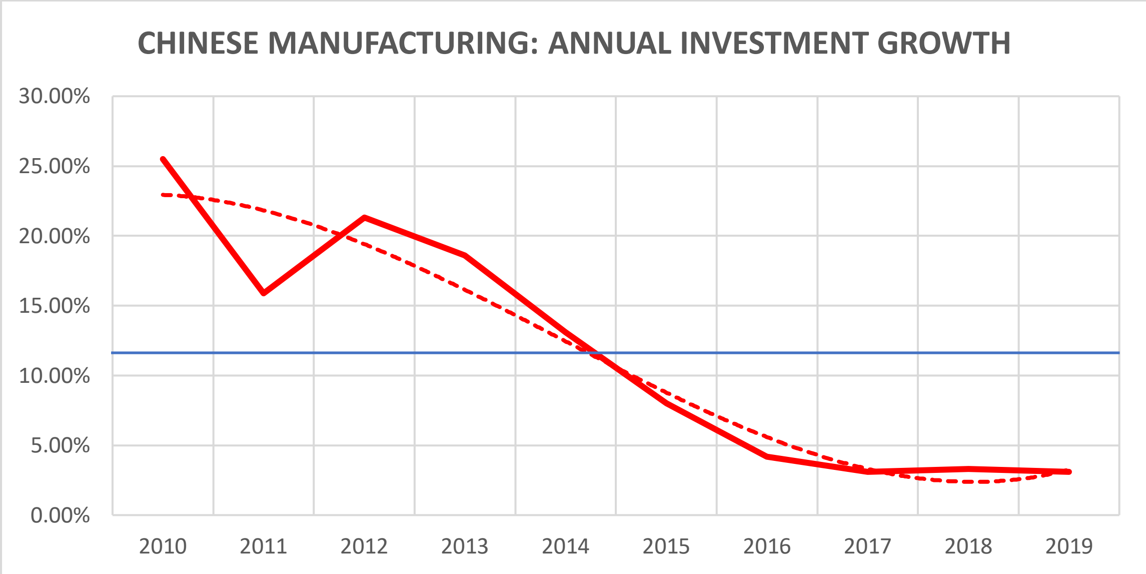
The profit induced fall in investment.

Both Michael Roberts and myself are adamant, based on the data, that it is profits that determines investment. The cart does not lead the horse. For proof of this, we should focus on China. China is at the heart of the global economy. Its contribution to global growth currently is 1.2% compared to the US contribution of 0.3%. Much of that contribution comes from its investment which is now falling precipitously. Indeed much of the industrial stagnation around the world is due to the collapse in the rate of investment growth in China. https://www.weforum.org/agenda/2016/09/why-china-is-central-to-global-growth

As Graph 4 and 5 below show, the annual growth in Chinese fixed investment has fallen from double figures to below 5% currently. The first graph covers manufacturing only and the second, longer perspective graph obtained from *TradingEconomics,* relates to total industrial investment. I have included manufacturing, because it is at the heart of Chinese industry, and because the fall in investment in that sector has been sharper. What both graphs show, is that investment fell below trend only after the complex rate of return reversed its rise. The rate of return plateaued between 2013 and 2015, meaning that any additional investment was no longer rewarded by additional profits. And, as the rate of return fell systemically after 2015, so did investment.

The blue line in Graph 4 represents the average rate of investment for the ten year period and all lines intersect at the end of 2014. In Graph 5, the 20% rate is breached at around the same time.

Graph 4.



Graph 5.

Conclusion.

It is worth repeating. The current period of globalisation had exhausted itself by the end of 2016, before Trump was elected and before the subsequent Trade War. The trade truce represented two tired and bruised boxers, barely standing, calling time out. Certainly, not a cause for celebration, or inviting them to a party. But this is the way the markets have treated this event. As expected, the recent soft surveys such as the PMIs have shown a rebound. It really is a source of concern that the financial world has misread the nature of truce, seeing it as a possible turnaround when in reality it temporarily stayed the downward fall.

The viral outbreak could not have come at a more vulnerable time. This is why it was greeted with such severe gyrations in share prices around the world. Over time, the actual effects of the disruptions and dislocations to the world economy will overwhelm the optimism that emerged after the trade war truce. The bear markets for oil and copper testify to that already.

How severe this dislocation will be, depends on how quickly an antidote is found. Quarantining whole cities and banning movement is economically quite catastrophic. Two factors are important, spread and length. Should this virus spread exponentially outside China, leading, if not to regional quarantining, then to travel bans and transport bans, a global recession is inevitable. Should the epidemic continue into late March, which marks the end of the influenza season as temperatures rise, but be largely confined to China, the global economy may escape recession. It is too early to say.

With viruses as with financial consequences, what is made in China nowadays is unlikely to stay in China. One side-effect of this virus will be to show how dependent the world economy is on China. This epidemic need not have happened, it is born not of the animal kingdom, but in the inhuman conditions imposed on Chinese workers, which because it is an afront to nature, causes natural calamities. Poverty and over-crowding have always been reservoirs for disease, which capitalism has reproduced countless time, since when it first created industrial cities over two centuries ago.

Note 1. The term, complex rate of return, identifies that this is not the normal rate of return which is based on profits divided by fixed assets. In China the term complex rate of return means profits are based on total assets, which include fixed assets, inventories and <u>financial assets</u>. Unfortunately, China does not provide tables based solely on fixed assets. Total assets in terms of financial assets is more pronounced in State Organised Enterprises because of their extensive cross-holdings which boosts their total assets. This gives the appearance that the rate of return is lower in State Enterprises compared to private companies whose total assets are smaller, which could be misleading as we are not comparing apples to apples.

Brian Green, 5th February 2020.