Written by Bob Adelmann on January 24, 2012

Keynesian Economists Agree: China to Have "Hard Landing"

Mainstream economist Robert Samuelson admitted last week that the case for the ending of the economic boom in China has some substance. Keynesian economist Paul Krugman also confirmed that China is in trouble and questioned its ability to avoid a hard landing.

Samuelson raised rhetorical questions about China's economic future, all with the same answer: "Could the world's economic juggernaut, having grown an average of 10 percent annually for three decades, face a slowdown…or a recession?" Yes, it could. "Does it have a real estate 'bubble' about to 'pop?' " Yes, it does. Could that have "global consequences?" Yes, it will.

Noting that Nomura Securities is predicting a one-in-three possibility of a hard landing — defined as a drop in China's GDP to five percent or less — Samuelson said that such a sharp slowdown "would raise unemployment and social discontent" with consequences similar to the start of the Great Recession between 2007 and 2009 in the United States. Samuelson admitted that the Chinese government has created what "seems [to be] a classic speculative bubble:

> People buy because they believe prices will go up, and prices go up because people buy…
>
> Unfortunately, booms breed busts. Buyers ultimately recognize that rising prices reflect artificial demand. Purchases slow. Prices fall. New building declines. The process feeds on itself. With modest imbalances, the result is a correction. Otherwise, there's a crash.

What's remarkable about Samuelson's explanation is that he is giving the Austrian school's explanation of what happens when Keynesian policies, which Samuelson supports, are employed. Ludwig von Mises, writing in his monumental *Human Action* in 1949, provided the same explanation:

> The credit boom is built on the sands of bank notes and deposits. It must collapse…If the credit expansion is not stopped in time, the boom turns into the crack-up boom; the flight into real values begins, and the whole monetary system founders.

Very late to the game, Samuelson admits that "China's economic model is reaching its limits…[and] its economy will slow."

Paul Krugman suffers from the same blind spot: recognizing the imminent collapse in China without accepting blame for the Keynesian policies that caused it. He wrote:

> Recent growth has relied on a huge construction boom fueled by surging real estate prices, and exhibiting all the classic signs of a bubble…

> Now the bubble is bursting — and there are real reasons to fear financial and economic crisis…
>
> [How] do we know that real estate was a bubble? It exhibited all the signs: not just rising prices, but also the kind of speculative fever all too familiar from our own experience just a few years back…
>
> I hope that I'm being needlessly alarmist here. But it's impossible not to be worried: China's story just sounds too much like the crack-ups we've already seen elsewhere. And a world economy already suffering from the mess in Europe really, really doesn't need a new epicenter of crisis.

If only Krugman had read von Mises!

The bad news from China reported here is getting notably worse. In 2011 China's net exports fell for the third time since 2000 which subtracted 0.5 percentage points from its 2011 GDP. Its housing boom continues to crater with prices of new homes falling in 52 out of 70 cities in December. Households can't obtain mortgage financing and developers are having trouble rolling over their existing debt. Foreign capital is fleeing China in enormous amounts, weakening the capital positions of the country's banks. Steven Green of Standard Chartered, a huge multinational financial firm, estimated that $185 billion left the country last year "through the VIP rooms of Macau's casinos."

Even the chief economist for the International Monetary Fund (IMF), Oliver Blanchard, has been forced to recognize reality, noting that "recovery is at a standstill in the advanced economies and…that 2012 may face even worse economic conditions than [in] 2008." Two economists writing at TripleCrisis.com said:

> This is extremely bad news for the developing world. Already it is evident that it is misplaced and even foolhardy to hope that economic expansion in China [and elsewhere] will be enough to compensate for the slowdown [worldwide]…
>
> As the housing bubble in China is pricked and real estate prices fall, this will have negative multiplier effects on all related activities in construction…the debt deflation associated with falling asset prices may also affect consumption and employment…
>
> So there are good reasons for Blanchard of the IMF and others to be gloomy…things are unlikely to look up in the coming year.

China now is the poster child for failed Keynesian policies. At long last those who supported those policies are finally beginning to see what they have wrought. Will the lesson be learned this time?

Photo: Bank of China Headquarters, ;Beijing, China.