

When USSR Disintegration Meets Japan's Lost Decade

Written by Leo Wang
Friday, 11 June 2010 11:59

In one word – China.

The recent international media's reporting on suicides and labor unrest at the 400,000 employee Foxconn factory near Shenzhen got me thinking. Here are some gathered notes and musings:

“...[B]ehind the surge of worker activism [such as the [Foxconn incident that lead to a doubling of worker's wages](#) so far] lies not ideology but some dull, fundamental data – demographics. This year the percentage of China's population of working age people (15 to 64) peaks at 71.9 percent, the culmination of a steady rise over 30 years. Together with the birth bulge which preceded the introduction of the One Child policy in 1980 this increase drove workforce growth of 33 percent in 30 years and helped to fuel the export sweatshops of southern China

(“
[China's Dwindling Resource](#)
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Philip Bowering,
International Herald Tribune
, June 3, 2010)
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Foxconn isn't alone in suffering from labor-relations problems: “Last week the Japanese automaker Honda said it had agreed to give about 1900 workers at one of its plants in southern China raises of 24 to 32 percent, in hopes of ending a two-week strike, according to people briefed on the agreement...Big manufacturers are moving to raise salaries because they are desperate to attract new workers at a time when many coastal factory cities are struggling with labor shortages (“[As China's Wages Rise, Export Prices Could Follow](#),” David Barboza, June 7, 2010).”

Here is another (perhaps bigger?) demographics time-bomb:

“ Another important marker is just five years away: The absolute size of the working age population will peak by 2015 and then decline gradually. In practice, the peak of available workers may have already arrived because more people stay in school longer and thus do not

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enter the workforce until much later than 15. The participation of women in the workforce at 70 percent is as high as it is likely to get (“[China's Dwindling Resource](#),” Philip Bowring, *International Herald Tribune*, June 3, 2010)
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If the gigantic property bubble in China bursts, that might temporarily alleviate young worker shortage problem of foreign firms investing in China. And this leads us to another big problem of the Chinese economy. As depicted in an interview by BusinessWeek (“[Short-Seller Jim Chanos: Red Flag Over China](#),” Charlie Rose, *BusinessWeek*, April 8, 2010), the hedge fund manager Jim Chanos guessed the time for China's real estate mania to end “...in late 2010, 2011.”

Chanos also thinks that China's real estate bubble is “a thousand times worse than Dubai.” “I think it's going to be that bad for the property market in China. Let's be clear: What we're talking about is a world-class – if not *the* world-class – property bubble”

Here are more of the hedge fund operator's facts and observations from the same interview:

“What we define as a bubble is any kind of debt-fueled asset inflation where the cash flow generated by the asset itself – a rental property, office building, condo – does not cover the debt incurred to buy the asset.”

“...[A]ccording to a news report...there's a developer that's going to put in a new Times Square in suburban Beijing, replete with 32 Broadway theater. You're beginning to hear about these bizarre developments in China, indoor ski resorts similar to what we saw in Dubai.”

“...[T]he real estate being built [in China] is not for the masses. This is not affordable housing for the middle class. This is high-end condos in major urban areas and high-end office buildings. Just to give you an idea, right now construction costs in China are starting to hit \$100 to \$150 per square foot in some cities. That doesn't sound like a lot by Western standards, but it means a condominium basically presented to you with no floors, no walls, no appliances costs

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the average Chinese two-income couple \$100,000 to \$150,000 U.S. That Chinese two-income couple in their 30s probably makes combined \$7000 or \$8000 a year. You do the math. Even if they were making \$10,000 to \$15,000 a year, they couldn't carry a \$150,000 condo. This is very similar to someone making \$40,000 in the U.S. At the height of our bubble buying a \$600,000 or \$800,000 house. We know how that ended."

He further observed: "The last two economies that had similar foreign currency reserves [as that of China's current \$2 trillion] relative to the size of their economies were Japan in 1989 and the U.S. In 1929. I'll let that be the end of that discussion."

Do you see a similarity between China and Japan in the late '80s here?

In the height of the Japanese asset price bubble, debt-fueled real estate speculation drove [the price of the land beneath Tokyo's Imperial Palace rediculously high: It was worth more than the entire state of California](#)

. The early '90s recession cooled this debt-fueled but insane dynamics. Its aftermath coupled with Japan's aging-population-induced weak demand resulted in *ushinawareta jūnen*, the "lost decade."

Here is author Harry Dent's observations on Japan's economy and demographics: "That drop-off in births during World War II caused an economic slowdown in Japan in the early '90s, from 1990 to 1992...Japan had a strong surge in births after World War II, from 1947 to 1950 when the soldiers came home. That caused the Japanese economy to rebound after 1992 into 1996, but at a lower rate because of the incredible devastation from the bursting of the economic bubble and the collapse of the banking system due to bad loans to corporations and real estate speculation. But then the real recession started in late 1996 and early 1997. Japan had a steep decline in births, or a baby bust, between 1950 and 1957, the very years when most countries, including the United States, had their largest baby booms. That means a dramatic slowdown in consumer spending from 1997 into 2004 on a 47-year lag for the peak in spending ([The Roaring 2000s Investor: Strategies for the Life You Want](#) , Harry S. Dent, Jr., p.p. 81-82) ..."

China's problem doesn't end here. Many commodities bottomed in 1999 or 2000. Historically, a *secular* commodities bull market in commodities lasts about two decades. That means we are likely to have approximately one more decade of rising food and energy prices. Here is

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another side-effect of China's population time-bomb:

“For China as a whole there are currently only 106 million workers in the 15-19 age group compared with 122 million in the 20-24 group. China now has 378 million in their 40s and 50s but only 273 million under 30. The decline, which is continuing, in the number of the young and mobile has been greatest in rural areas...[W]hat will happen to agriculture as rural populations get ever older. Will consolidation of land holdings, now that transfers of agricultural land are allowed, happen on a big enough scale to allow the rapid mechanization of farming? Or will rural de-population and water shortages threaten a food crisis (“ [China's Dwindling Resource](#),” Philip Bowring, *International Herald Tribune*, June 4, 2010) ?”

Good questions. So we are left with the following scenario: the debt-fueled Chinese property bubble which is one thousand times worse than Dubai pops simultaneously with the implosion of baby bust time-bomb that have negative consequences on both production and consumption side of the economy; at a time of soaring global commodities prices while the Chinese country-side is being de-populated, environmentally degraded, and grossly neglected. I see hyperinflation, widespread riots, mass starvation, and the ensuing political instability...

All leading up to a Soviet-style breakup – and break-down.

So what to do with Foxconn and all the Taiwanese and rich country multinational firms' labor unrest issue? I have a better, though dramatic, solution than simply raising the workers' salaries: **Cut losses and get the hell out China ASAP.**

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